

**SOCIAL SECURITY AND RAILROAD RETIREMENT
PROPOSALS CONTAINED IN THE PRESIDENT'S
FISCAL YEAR 1988 BUDGET**

HEARING
BEFORE THE
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
ONE HUNDREDTH CONGRESS

FIRST SESSION

MARCH 5, 1987

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**SOCIAL SECURITY AND RAILROAD RETIRE-
MENT PROPOSALS CONTAINED IN THE PRESI-
DENT'S FISCAL YEAR 1988 BUDGET**

THURSDAY, MARCH 5, 1987

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SOCIAL SECURITY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room B-318, Rayburn House Office Building, Hon. Andy Jacobs, Jr. (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
MONDAY, FEBRUARY 9, 1987

SUBCOMMITTEE ON SOCIAL SECURITY #1
COMMITTEE ON WAYS AND MEANS
-U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-3627

ANDY JACOBS, JR. (D., IND.),
CHAIRMAN, SUBCOMMITTEE ON SOCIAL SECURITY,
COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A HEARING ON SOCIAL SECURITY AND
RAILROAD RETIREMENT PROPOSALS CONTAINED IN
THE PRESIDENT'S FY 1988 BUDGET

Andy Jacobs, Jr. (D., Ind.), Chairman of the Subcommittee on Social Security, Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee will conduct a hearing on the social security and railroad retirement proposals contained in the President's Fiscal Year 1988 budget. The hearing will be held on Thursday, March 5, 1987, in room B-318 Rayburn House Office Building, beginning at 10:00 a.m.

With respect to social security, the hearing will focus upon the various proposals in the President's budget to expand the Federal Insurance Contribution Act (FICA) payroll tax base to include certain earnings exempt under current law (e.g., wages received by Armed Services reservists, students, a portion of tip income, etc.). With regard to railroad retirement, the hearing will review the proposal to increase tier II taxes to improve the medium- and long-range outlook for the solvency of the railroad retirement pension fund, as well as the proposal to introduce rail-sector financing of part of the cost of vested dual or "windfall" benefits.

The Subcommittee will receive testimony from invited witnesses and interested public witnesses.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Requests to be heard must be made by telephone to Harriett Lawler [telephone (202) 225-3627] by the close of business Thursday, February 26, 1987. In order to facilitate scheduling, requests should indicate the specific issues which the witness wishes to address and the relative priority of each issue if more than one issue is indicated, in order to facilitate scheduling. The request should be followed by a formal written request addressed to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, room 1102 Longworth House Office Building, Washington, D.C. 20515. The Subcommittee will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff [(202) 225-3263].

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are requested to briefly summarize their written statements in no more than five minutes. THE FIVE-MINUTE RULE WILL BE STRICTLY APPLIED. The full statement will be included in the printed record.

(OVER)

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In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 100 copies of their prepared statements to the Subcommittee on Social Security office, room B-316 Rayburn House Office Building, at least 24 hours in advance of their scheduled appearances. Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENT IN LIEU OF PERSONAL APPEARANCE:

Persons submitting a written statements in lieu of a personal appearance should submit six (6) copies of their statements by the close of business Thursday, March 19, 1987, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, room 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing a written statement for the record of the printed hearing wish to have their statement distributed to the press and the interested public at the hearing, they may provide 75 additional copies for this purpose to the Subcommittee office, room B-316 Rayburn House Office Building, during the course of the public hearing.

SEE ENCLOSED FORMATTING REQUIREMENTS.

* * * * *

Chairman JACOBS. Will the witnesses Gielow, Chamberlain, and Crawford please come forward. This hearing concerns certain tax increases recommended by the administration with respect to the railroad retirement system and the Social Security system.

I shall put Mr. Archer's statement in at this point.
[The statement follows:]

STATEMENT OF HON. BILL ARCHER, RANKING MEMBER, SUBCOMMITTEE ON SOCIAL SECURITY

Thank you Mr. Chairman. May I say what a pleasure it is to work with you as Chairman of the Social Security Subcommittee in this 100th Congress. You once remarked, I think, that the two of us have served together on this Subcommittee since before it was created. I look forward to continuing to work with you because I recognize your sincere commitment to the effective operation of our social security system.

Today's hearing centers on FICA and Railroad-related proposals in the President's budget. It is appropriate that we review periodically the limited exemptions from earnings covered by social security. Both law and long-standing program philosophy hold that all remuneration earned in the course of employment should be covered in the tax base unless specifically exempted. Exemptions have been limited because they reduce the value of the protection offered by Social Security. I believe the Administration has called to our attention several exclusions which have little justification.

I am particularly pleased at the proposal to cover—in a family business operated as a sole proprietorship—the wages of one spouse who works for the other. The original exclusion of a spouse's earnings came at a time when as little as six quarters of coverage insured some workers for a lifetime of retirement benefits. It appeared then that a family business might be able to "game" the system. But, that rationale is no longer valid. The system has matured. We have passed that point and are approaching a time when retirees will need the full 40 quarters of coverage for regular benefits.

In recent years, some of my constituents and colleagues in this body have shared with me the hardships resulting from current law. Wives—and it is usually wives who work in their husbands' businesses—have been distressed to learn that, despite their years of work, they have no disability protection. Some ex-wives have suffered financially because their benefits are based on the spouse's rate (which is usually one-half that of worker's) rather than at the worker's rate. Extending coverage to spouses would in my opinion be most beneficial to those spouses.

There are other interesting items to consider in this general context. I am sure that some of today's witnesses will address the need for continuing specific current exemptions, and I will keep an open mind. The question I would expect each to consider is why we exempted the earnings initially and what, if anything, has changed in the relevant workplace.

Chairman JACOBS. The gentlemen at the table represent the Railroad Retirement Board, and you all know the rules of the New York State Athletic Commission. It is a 5-minute statement per person. Members of Congress hear the gavel in mid-syllable, and you will hear it as well, in mid-syllable, when 5 minutes have expired.

It is a kindness, I think, to the people at the whip end of the witness list. Please proceed.

STATEMENT OF ROBERT A. GIELOW, CHAIRMAN, U.S. RAILROAD RETIREMENT BOARD

Mr. GIELOW. Thank you, Mr. Chairman. I am Mr. Gielow, Chairman of the Railroad Retirement Board, and Mr. Crawford on my right, and Mr. Chamberlain on my left, and we appreciate the opportunity to appear before you this morning, and we have prepared statements which we would appreciate submitting for the record.

I would like to just make a few brief remarks in sort of summary and background of my statement, after which Mr. Chamberlain and Mr. Crawford would like to make a presentation.

I have felt right along that the Board is an administrative body and really not a legislative policymaker. However, I feel on this question of the 1½ percent tax increase, that this is an exception. The Solvency Act of 1983 called on the Board to make an evaluation, and make a recommendation to Congress about the solvency of the Railroad Retirement Trust Fund. We did make this report in our section 502 report, recommending an increase.

Since that time, the employment level has continued to decline, and I am now recommending a 1½ percent increase in 1988, and again in 1989.

These increases are justified by the actuarial studies that the Board has made, and on that basis, the Board is recommending the two increases. Additionally, we do not want to make a recommendation as to where these should be applied. In other words, I think this is a question for rail labor and for rail management in their regular negotiations to determine where the increase should be applied.

That is my statement, and then I would like to turn it over to Mr. Chamberlain.

[The prepared statement follows:]

STATEMENT OF ROBERT A. GIELOW, CHAIRMAN OF THE
RAILROAD RETIREMENT BOARD

U.S. House of Representatives
Subcommittee on Social Security
Committee on Ways and Means
March 5, 1987

I support the President's proposal to increase the tier 2 tax by 1.5% in 1988, and another 1.5% in 1989. In the Board's 1986 Report on the Actuarial Status of the Railroad Retirement Account, as required by Section 502 of the Solvency Act, I stated that it was necessary to increase the tier 2 tax rate and to watch closely the railroad employment trend over the coming year. Employment figures since that report show a decline in 1986 (7%) almost equal to 1985 (8%), with no indication of change. At the same time, it should be noted that even with the 1986 figures taken into account, our Chief Actuary projects at the end of 1992 greater trust fund balances than exist today, but then declining rather than growing as they are today. The Board's Section 22 report dated January 29, 1987, reflected those balances, and informed the President and the Congress that sufficient funds are available for the payment of full benefits at least over the next five years. In the short term, benefits are not in danger. However, the long-term ability of the trust funds to pay benefits requires some corrective action. Obviously, the sooner that corrective action is taken, the smaller it will need to be. With respect to the question of who should pay the additional tax, I believe first it would be fully financed by the rail sector. Since the programs benefit the rail population, and since only it will be involved in providing the additional revenue, I believe it best to allow rail labor and rail management to work out the details within the next 60 days so long as the recommended amount of income is derived. If not, Congress would levy the taxes based on policy considerations. I would also assure the subcommittee that these increases are needed to ensure the actuarial soundness of the Railroad Retirement Trust Fund. In this context only, irrespective of the needs of the overall Federal budget, these changes are warranted.

The second Administration proposal the subcommittee is examining is the rail sector financing of a portion of the dual benefit costs. This proposal would have 25% of the costs funded from the Railroad Retirement Account. This would represent \$92 million of the projected \$368 million to fully fund dual benefits also known as windfalls in fiscal year 1988. Based on the aforementioned actuarial problems, an additional increase in the tier 2 tax is necessary to enable the trust fund to finance this added cost without jeopardizing regular benefits in the future. I am also advised that legislation may be required in order to transfer funds from the Railroad Retirement Account to the Dual Benefits Payments Account.

This proposal is an outgrowth of two General Accounting Office (GAO) reports that pointed out that, in the late 1960's, rail industry pension increases were offset by increases in social security benefits for individuals who received both benefits. Those offsets were translated in the 1981 Railroad Retirement Act amendments to a reduction in tier 2 benefits, equal to 25% of the amount of dual benefits paid to an individual. The argument is that the rail sector has been allowed to realize a substantial savings at the expense of general revenues, which currently fully fund dual benefit costs. The Railroad Retirement Account has had reduced obligations all the way back to 1966 as a result. This reduction provision was designed to shore up the rail industry pension fund before general revenue financing of windfalls began. Having the rail sector finance 25% of dual benefits would not affect the status of the fund and would reduce the current windfall subsidy of some \$1,100 per railroad employee to \$20.

Additional proposals may be of interest to you, Mr. Chairman. On behalf of the Administration, I advance the proposal to restore to the Social Security Administration the adjudication and payment of rail social security benefits. This proposal is part of the Administration's fiscal year 1988 proposal to privatize rail industry pensions.

In addition to rail industry pensions and other add-ons, the railroad retirement system currently pays social security equivalent benefits that are basically identical to social security benefits. Rail employers and employees each pay contributions equivalent to social security to fund these benefits. Continuing to exclude rail workers from social security coverage is difficult to justify when rail workers receive benefits and are taxed under a program specifically intended to mirror the social security program.

Covering all railroad service performed after December 31, 1988, under social security would end this anomaly. Railroad retirees would be able to seek service from some 1,200 social security district offices, instead of being limited to some 100 railroad retirement offices nationwide. The Railroad Retirement Board has one or no office in 24 States. Having one system for collecting all social security taxes and paying all benefits would simplify and improve administration for all social security beneficiaries, and would improve service to railroad retirees.

The Administration proposes to include rail workers under the income security umbrella of the Federal/State unemployment insurance system. This proposal would not only ensure comprehensive unemployment insurance coverage and generally higher benefits for rail workers, but would also repay the rail unemployment insurance fund's \$800 million debt to the rail industry pension fund.

I hope the foregoing sheds light on some of the issues facing the subcommittees and is beneficial to your deliberations.

Chairman JACOBS. Thank you, sir. Mr. Chamberlain.

**STATEMENT OF C.J. CHAMBERLAIN, MEMBER (LABOR), U.S.
RAILROAD RETIREMENT BOARD**

Mr. CHAMBERLAIN. Thank you, Mr. Chairman.

Certainly it is a pleasure to appear before you this morning.

During 1983, the retirement system faced its most severe crisis in the trust fund's 50 year history; and through the responsible efforts of everyone involved in our system, as well as the support of the congressional committees having oversight over our operations, the Solvency Act was overwhelmingly passed into law.

Today, the fund is solvent as a result of that, and we are able to pay the full level of benefits provided by current law.

Short-range projections made in the agency's first four section 22 reports clearly show a growth in the fund's reserve during the next 5-year period, even under deliberately pessimistic employment assumptions.

While these are good signs, and certainly represent a substantial turnaround from the position we found ourselves in at the beginning of this decade, the agency must be extremely sensitive to the long-range effects of the recent trends in the rail industry to systematically reduce the work force.

We cannot ignore the fact that nationwide buyouts, consolidations and mergers, together with significant reductions in the entry rates for newly hired employees will have, and have had, an ultimate effect on the trust fund's stability.

Under section 502 of the Solvency Act, the Board is required to closely monitor such trends and their long-term effects, and must make recommendations to help ensure that any problems that may arise will be observed and resolved long before a crisis develops.

Even though there are no immediate difficulties evident, the clear intent of section 502 was to avoid the problem that we had 4 years ago.

We reviewed the chief actuary's 1986 report, and can find no fault with the assumptions and the projections contained therein. While the recommendations concerning the increase in the tier II tax rate for January 1, 1987, of 1.5 percent, and a further 1.5 percent on January 1, 1988, contingent on the findings of this year's section 502 report are disappointing, they are nevertheless realistic based on the past year's deterioration of railroad employment levels.

You know, employees have no control over these policies, and have in fact been called upon to make further sacrifices beyond the 1983 provisions as a result of recently legislated reductions in benefits and the extension of taxation provisions.

The level of railroad employment is entirely within the control of railroad management. It is simply not equitable for railroad management to reduce its payroll costs bringing about funding problems in the retirement system, and then to ask the workers and beneficiaries to finance the resulting deficit.

Back in 1974, Mr. Dempsey, who was chairman of the National Railway Conference, at that time made the following statement:

The railroad industry is perfectly prepared to fund the railroad retirement system in every respect in which it bears a reasonable resemblance to any other private industry pension plan, and what that means is that if somehow these figures go askew and we run into difficulty in the future because we have not put enough money in with relation to the benefits that are being provided, we will fund that, we will take care of it. That is our responsibility.

Last September, in transmitting the annual report of the Railroad Retirement Board for fiscal 1985 to Congress, President Reagan made the following observations:

The Retirement Board's chief actuary informs me he anticipates cash-flow problems in the rail industry pension fund, and states that "upward adjustment in financing can no longer be regarded as premature."

Refinancing legislation enacted in 1974, 1981, and 1983 has been required to prevent the rail pension fund from going broke three times in the last decade, and significant, constant declines in rail employment levels continue to deteriorate rail pension assets. With yet another financial crisis threatening the pension fund's ability to pay railroad retirees' benefits, the administration agrees with the Board's chief actuary, Board Chairman Gielow, and Board Member Chamberlain that measures are needed now to forestall financing problems. I therefore concur with Mr. Chamberlain that raising rail management pension contributions 1.5 percent on January 1, 1987, is a prudent course to follow.

It is possible, Mr. Chairman, that if subsequent reports, future reports reflect a reversal of the current trend of the employment deterioration, future tax increases may not be necessary, and they can be so noted in those reports.

With respect to the proposals of the administration for rail sector financing of a portion of dual benefit costs, when the Retirement Act of 1974 was passed, it was agreed that it was a Federal responsibility to fund the costs of dual benefits, and that the railroad industry would fully fund other benefits payable under the Retirement Act to the extent they exceed benefit levels that would have been payable under Social Security.

This matter has been dealt with in 1974, it was dealt with again in 1983, and there is just no question about it, that the Congress affirmed their commitment to the rail community to fully fund this benefit and reaffirmed that commitment in 1983. It should be fulfilled.

[The prepared statement follows:]

Before the
SUBCOMMITTEE ON SOCIAL SECURITY
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

STATEMENT OF C. J. CHAMBERLAIN, LABOR MEMBER,
U. S. RAILROAD RETIREMENT BOARD

ON PROPOSALS IN THE FISCAL YEAR 1988 BUDGET
RELATING TO THE RAILROAD RETIREMENT SYSTEM

March 5, 1987

During 1983, the Railroad Retirement System faced its most severe financial crisis in the trust fund's 50 year history. Through the responsible efforts of everyone involved in our system, as well as the support of the Congressional Committees having oversight of our operations, the 1983 Solvency Act was overwhelmingly passed into law. As the result of the financing and entitlement provisions of that Act, the condition of the trust fund has been greatly strengthened. Today the fund is solvent and able to pay the full level of benefits provided by current law. Short range fund projections made in the agency's first four Section 22 reports clearly show a growth in the fund's reserve during the next 5 year period, even under deliberately pessimistic employment assumptions.

While these are good signs and represent a substantial turn-around from the position we found ourselves in at the beginning of this decade, the agency must be extremely sensitive to the long-range effects of recent trends in the rail industry to systematically reduce the work force. We cannot ignore the fact that nationwide buy-outs, consolidations and mergers, together with significant reductions in the entry rates for newly hired employees, will ultimately affect the trust fund's stability.

As required under Section 502 of the Solvency Act, the Board must closely monitor such trends and their long-term effects, and must make recommendations to help ensure that any problems that may arise will be observed and resolved long before a crisis develops. Even though no immediate difficulties are evident, the clear intent of Section 502 was to avoid the problem we had just four short years ago. We must recall that in years prior to the realization of the 1983 crisis, the projections and assumptions of our actuarial staff were labeled then as too pessimistic, and were not heeded. It is imperative that the Board not hesitate to react to employment trends (as well as external factors such as the proposed elimination of Amtrak) that will affect our fund's future stability regardless if such effect be now, or in the next century.

We have reviewed the Chief Actuary's 1986 report and can find no fault with the assumptions and projections contained therein. While the recommendations concerning the increase in the Tier II tax rate for January 1, 1987 by 1.5 percent and a further increase of 1.5 percent on January 1, 1988 contingent on the findings of this year's Section 502 report are disappointing, they are nevertheless realistic based on the past year's deterioration of railroad employment levels. As the current situation is solely the result of an industry-wide policy to systematically reduce the work force, while at the same time decreasing the available tax base through reductions in entry level pay, any tax adjustments should be borne solely by the employers. Employees have no control over these policies and have in fact already been called upon to make further sacrifices beyond the 1983 provisions as a result of recently legislated reductions in benefits and extension of taxation provisions. The level of railroad employment is entirely within the control of railroad management. It is simply not equitable for railroad management to reduce its payroll cost, bringing about funding problems in the retirement system, and then to ask the workers and beneficiaries to finance the resulting deficit. William H. Dempsey, then Chairman of the National Railway Labor Conference, made the following statement in support of the bill which was eventually enacted as the Railroad Retirement Act of 1974:

The railroad industry is perfectly prepared to fund the railroad retirement system in every respect in which it bears a reasonable resemblance to any other private industry pension plan, and what that means is that if somehow these figures go askew and we run into difficulty in the future because we have not put enough money in with relation to the benefits that are being provided, we will fund that, we will take care of it -- that is our responsibility.

Railroad management must fulfill its commitment to finance the retirement system in a responsible manner.

Last September, in transmitting the Annual Report of the Railroad Retirement Board for fiscal 1985 to Congress, President Reagan made the following observations:

The Railroad Retirement Board's chief actuary informs me he anticipates cash-flow problems in the rail industry pension fund, and states that "an upward adjustment in financing can no longer be regarded as premature." Refinancing legislation enacted in 1974, 1981, and 1983 has been required to prevent the rail pension fund from going broke three times in the last decade, and significant, constant declines in rail employment levels continue to deteriorate rail pension assets. With yet another financial crisis threatening the pension fund's ability to pay railroad retirees' benefits, the Administration agrees with the Board's chief actuary, Board Chairman Gielow, and Board Member Chamberlain that measures are needed now to forestall financing problems. I therefore concur with Mr. Chamberlain that raising rail management pension contributions 1.5% on January 1, 1987, is a prudent course to follow.

Accordingly, the only prudent course of action is to adopt the Chief Actuary's recommendations. Furthermore, it is our recommendation that the necessary tax adjustments be borne solely by rail employers, as it is clear that although the Solvency Act provisions are working, recent trends in employment policies will ultimately affect the stability of the trust fund. Of course if subsequent reports reflect reversal of the current trend, future tax increases may not be necessary and can be so noted in those reports.

We cannot agree however with proposals for "rail-sector" financing of a portion of the dual benefit costs. When the Railroad Retirement Act of 1974 was passed, it was agreed that it was a Federal responsibility to fund the costs of dual benefits, and that the railroad industry would fully fund other benefits payable under the Railroad Retirement Act to the extent they exceed benefit levels that would have been payable under the Social Security Act. That agreement by the railroad industry was premised on an understanding that there would be no change in the obligation of the Railroad Retirement Account from that existing under the previous 1937 Act. Such a change as is contemplated by this proposal would be contrary to the understanding which was created in 1974. It represents an attempt to shift a portion of the costs of dual benefits from the Federal government to the railroad industry. The potential trust fund problems discussed above would only be exacerbated by the current proposal to, in effect, impose a new excise tax on the Tier II tax base which will generate revenue equal to 25 percent of the dual benefit payments. In 1974 Congress affirmed their commitment to the rail community to fully fund this benefit and reaffirmed their commitment in the Railroad Retirement Solvency Act of 1983. This commitment should be fulfilled.

C. J. Chamberlain

Chairman JACOBS. Thank you, sir. Mr. Crawford.

STATEMENT OF JOHN D. CRAWFORD, MEMBER (MANAGEMENT),
U.S. RAILROAD RETIREMENT BOARD

Mr. CRAWFORD. Mr. Chairman, I appreciate having the opportunity to comment on the railroad retirement tax proposals contained in the President's fiscal year 1988 budget, and as a summer resident of the State of Indiana, I feel very comfortable appearing before this subcommittee.

In the report submitted to Congress in accordance with section 502 of the 1983 Solvency Act last June, I stated that the chief actuary's recommendation of a tier II tax increase appeared to be premature.

However, in view of the continued decline in average midmonth railroad employment since that time, it cannot be denied at this time that the actuarial soundness of the Railroad Retirement Account requires some action by Congress.

Mr. Mentz of the Treasury Department testified before the House Ways and Means Committee last month, and mentioned a proposed increase of 1.5 percent January 1, 1988, and 1.5 percent January 1, 1989.

He stated that this should be shared between the employers and employees. I agree with him on that proposal. However, I think that the possibility of an adjustment in benefits which was suggested by the chief actuary as an alternative should also be considered.

In any event, I think that the parties most interested, that is, labor and management, should be given some time, a reasonable time to study the problem, and come up with some suggested solutions for Congress, as they have for the last 50 years.

With regard to the offset of so-called windfall benefits, or dual benefits, the history of that provision for an offset of 25 percent is somewhat similar to the history of the dual benefits themselves.

Back in the late 1960's, there were three occasions on which the Congress permitted increases for all railroad retirees, and was able to give them a larger increase than would normally have been possible, by reducing through an offset the tier II benefits of those who were entitled to both a full Social Security benefit, and a full Railroad Retirement Act benefit.

And now, although in 1974, 1981, and 1983, Congress was aware that this offset was in effect, and Congress nevertheless assumed responsibility for fully funding the windfall benefit, the proposal is that this savings, which was intended to recompense for a higher increase for people not entitled to dual benefits, should be taken away from the railroads.

This has been considered by Congress several times before, and with the present burden on the employees and the employers, I do not think that the Railroad Retirement Account should be expected to assume the added burden which has been proposed with regard to the windfall benefits.

Thank you for the opportunity to present my views.

[The prepared statement follows:]

STATEMENT OF JOHN D. CRAWFORD
MANAGEMENT MEMBER, RAILROAD RETIREMENT BOARD
SUBCOMMITTEE ON SOCIAL SECURITY
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
MARCH 5, 1987

Mr. Chairman and Members of the Committee, I appreciate having the opportunity to comment on the railroad retirement tax proposals contained in the President's Fiscal Year 1988 budget.

In the report submitted to Congress in accordance with Section 502 of the 1983 Solvency Act, last June, I stated that the Chief Actuary's recommendation of a Tier II tax increase appeared to be premature. However, in view of the decline in the mid-month count of railroad employees from 343,000 in May 1986 to 308,000 in January 1987, and the decline in the yearly average from 372,000 in 1985 to 338,000 in 1986, it cannot be denied at this date that the actuarial soundness of the Railroad Retirement Account requires some action by Congress.

In his statement before the House Ways and Means Committee on February 3, 1987, the Assistant Secretary (Tax Policy) of the Department of the Treasury, Mr. J. Roger Mentz, mentioned a proposed increase of 1.5% in Tier II taxes effective January 1, 1988, and an additional 1.5% in Tier II taxes effective January 1, 1989.

Mr. Mentz also stated that the increase in Tier II taxes should be shared by the employers and the employees. I agree with this recommendation. However, before any decision is made as to the size of and the effective date of any Tier II tax increase, it is my opinion that the views of labor and management should be considered. It will be noted that in the Chief Actuary's recommendation last June, reference was made to an adjustment in benefits as being another alternative. Historically, the views of the railroad management and the Railway Labor Executives' Association have been sought by Congress before making a decision on such matters which are so crucial to the welfare of the employees and of the industry itself. In view of the complexity of this problem, and the fact that even under the most pessimistic assumptions the retirement funds are adequate to cover benefits until after the end of this century, it might be well to give labor and management a reasonable time to discuss these matters before making any changes.

With regard to the proposal to have the employers pay 25% of the costs of dual benefits under the Social Security Act and the Railroad Retirement Act, this would require payment of an additional \$92 million in payroll taxes by the employers during Fiscal Year 1988. This would be equivalent to an additional 1.1% tax on Tier II payrolls during FY-88.

The history of this offset provision is somewhat similar to the history of the dual benefits themselves. With respect to dual benefits, Congress knowingly required the Railroad Retirement Trust Fund to pay excessive benefits that should have been paid out of Social Security funds prior to 1974, and Congress agreed to fund these dual benefits after 1974 instead of taking them away from those employees or beneficiaries whose rights had vested. With regard to the offset of Tier II benefits for those receiving dual benefits, Congress also made an arrangement in the 1960's to provide greater increases in benefits in railroad retirement annuities of beneficiaries who were not entitled to dual benefits, by holding down the increases in benefits for those beneficiaries who were entitled to an increase in benefits under both the Social Security Act and the Railroad Retirement Act.

The Railroad Retirement Act of 1937 required that the amounts of increases in an individual's social security benefits resulting from the Social Security Amendments of 1965, 1967, and 1969, be set off against the individual's corresponding railroad retirement annuity increases provided in 1966, 1968, and 1970. In this regard it should be noted that these offset provisions reduce only the increases in an individual's railroad retirement annuity so that such increases are smaller than they would have been if the individual had not been entitled to a social security benefit.

In enacting the above-discussed offset provisions, Congress acted on the belief that annuitants who had received a cost-of-living increase in their social security benefits needed a full increase in their railroad retirement annuities to a lesser degree than annuitants who were receiving only railroad retirement annuities. If those provisions had not been adopted, it would have been necessary to reduce the amounts of the benefit increases for all beneficiaries in the years in question in order to keep the costs of such increases from being excessive. The alternative as selected by Congress was to provide smaller increases in the annuities of those entitled to dual benefits.

The Railroad Retirement Act of 1937 was replaced effective January 1, 1975, by the Railroad Retirement Act of 1974. The offset provisions were carried over and are applicable to anyone who receives windfall benefits under both the Railroad Retirement Act and the Social Security Act.

This proposal to require the railroad industry to assume financial responsibility for that portion of the windfall benefits which is offset against Tier II benefits has been presented to Congress several times since 1981, and Congress has refused to change the arrangement made in 1974.

The 1981 Amendments to the Railroad Retirement Act simplified the computation of the offset by providing that the reduction in Tier II benefits should be equal to 25% of the windfall benefit. However, Congress made no change in its 1974 commitment to finance 100% of the windfall benefits from general revenues.

Again in the Railroad Retirement Solvency Act of 1983, when Congress made up for the shortfall in appropriations for windfall benefits for the period 1975 to 1981, Congress reaffirmed its commitment as to the sharing of the burden between the railroad industry and general revenues by making no change in the 25% offset.

Under the present proposal, the employers would be required to pay for the higher benefits provided in 1966, 1968 and 1970 for beneficiaries not entitled to dual benefits, and then pay again for the offsetting savings which Congress provided for in the 1960's and reaffirmed in 1974, 1981 and 1983. With the level of taxes now being paid by the employers and employees, I do not think this Congress should go back on the long-standing arrangements for the financing of dual benefits.

Thank you for the opportunity to present my views.

Chairman JACOBS. We are grateful to the panel for your enrichment of the record. You are dismissed. Will the next panel please come forward: R.T. Bates, William H. Dempsey, and Charles I. Hopkins of the Railway Labor Executives' Association.

If you gentlemen wish to proceed in the manner you are listed, or if you have agreed among yourselves to proceed in some other order, that is all right.

STATEMENT OF R.T. BATES, CHAIRMAN, RAILROAD RETIREMENT COMMITTEE, RAILWAY LABOR EXECUTIVES' ASSOCIATION, AND PRESIDENT, BROTHERHOOD OF RAILROAD SIGNALMEN

Mr. BATES. My name is Tom Bates. I am chairman of the Railway Labor Executive's Association Committee for Railroad Retirement.

I am also the president of the Brotherhood of Railroad Signalmen located in Mount Prospect, IL.

You no doubt are aware that the Railway Labor Executives' Association is comprised of the presidents of all of the standard railroad labor organizations, and speak for virtually all of the employees employed on class I railroads in the United States.

The chief actuary of the Railroad Retirement Board recommended that the tier II railroad retirement tax rate be increased by 1.5 percent on January 1, 1987 and again on January 1, 1988.

The administration's fiscal year 1988 budget seeks the 1.5 percent on January 1, 1988, and again on January 1, 1989.

The budget also proposes that 25 percent of the vested dual benefits be paid from the Railroad Retirement Account. Traditionally, these changes in benefits and taxes for the railroad retirement system have been negotiated by the railway labor organizations, and railroad management.

We believe the burden of the increased taxes should be borne by the railroads because the current financial projections are based solely upon the industry-wide policy of reduction in the work force, and, at the same time reducing the available tax base by reductions in the entry-rate levels of compensation.

The railroads make every effort to remove workers from coverage by the Railroad Retirement Tax Act, by the employment of workers not directly employed by the railroads but performing railroad work as employees of contract forces.

Employees have no control over these policies. Notwithstanding this position, we also believe that rail management and rail labor should have an opportunity to sit down and discuss and negotiate any changes that will stabilize the railroad retirement fund.

The administration's Office of Management and Budget also proposes that 25 percent of the remaining cost of dual benefits be financed from the railroad retirement trust fund.

In 1974, 1981, and 1983, Congress rightfully assumed that burden, and rail labor opposes using funds from the Railroad Retirement Account to finance a windfall dual benefit.

OMB Director Stockman supported making the dual benefits a fully funded entitlement in 1983. As indicated in our statement there is no immediate crisis in the funding of the railroad retirement system and we urge your committee to permit rail manage-

ment and labor an opportunity to negotiate and make recommendations for the resolution of this most important matter.

Thank you very much.

[The prepared statement follows:]

Before the
SUBCOMMITTEE ON SOCIAL SECURITY
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

STATEMENT OF R. T. BATES, CHAIRMAN, RAILROAD RETIREMENT COMMITTEE,
RAILWAY LABOR EXECUTIVES' ASSOCIATION; AND, PRESIDENT,
BROTHERHOOD OF RAILROAD SIGNALMEN

ON PROPOSALS IN THE FISCAL YEAR 1988 BUDGET
RELATING TO THE RAILROAD RETIREMENT SYSTEM

March 5, 1987

Among its numerous recommendations, the Administration's FY 1988 Budget calls for a 1.5% increase in Tier II railroad retirement tax rate effective January 1, 1988, and a second such increase on January 1, 1989. The Administration also proposes that 25% of the costs of vested "windfall" dual benefits be paid from the Railroad Retirement Account that is funded by the Tier II railroad retirement taxes.

The Administration's budget proposal for increasing Tier II railroad retirement tax rates is based upon a recommendation of the Chief Actuary of the Railroad Retirement Board who also concluded that "Congress may find it appropriate to allow railroad labor and management to prepare joint recommendations regarding the proportion of tax increases to be borne by employers, the proportion to be borne by employees, and what, if any, adjustments are to be made in benefits." Rail Labor endorses that suggestion of the Chief Actuary and urges upon the members of this Committee and the Congress to permit the opportunity for labor and management to resolve this problem at this time as the Congress has historically done in the past.

Over the past few years, railroad annuitants have had their benefits cut and their taxes increased. The active railroad employees, who along with their employers financed the railroad retirement system, have had their taxes increased to the point where they now pay 13.83% of Tier II taxable compensation. Because of the complexity of the problems involved, the Congress has historically permitted rail labor and management to bargain and agree upon joint recommendations to the Congress that take into consideration the peculiar problems and difficulties confronted by active rail labor, the retired and disabled, and rail management. Congress traditionally has accorded great weight to those recommendations in its deliberations upon amendments to the Railroad Retirement System. We respectfully urge that the Congress again permit the industry to recommend to you what we at least would consider as solutions to future problems which may arise within the system.

We say "future" problems because there is no immediate crisis confronting the railroad retirement system. As the Board's Actuary has said: "the railroad retirement system's fund is expected to continue growing for several years without new legislation, even under the most pessimistic employment assumption". He then concluded

that there "is no immediate danger of having to curtail benefits in the absence of additional financing". In view of this conclusion, it would seem the most appropriate course to follow in this situation would be to have labor and management negotiate joint recommendations to the Congress which could then be considered for incorporation into the law. Indeed, labor and management have met and discussed in general terms what needs to be done but because of national negotiations which have taken up so much of their time in recent months, we have not been able to provide this subject with the time and attention necessary to reach joint recommendations. The national negotiations are now behind us and we can devote the necessary time and attention to reaching agreement upon these matters. We ask that the Congress give us the opportunity to do so.

Also included in the FY 1988 Budget of the Administration is a recommendation that 25% of the costs of vested "windfall" dual benefits be paid out of the Railroad Retirement Account that is funded by Tier II railroad retirement taxes. In 1954, the Congress eliminated the so-called "dual benefit" restriction thereby allowing employees who qualified for both railroad retirement and social security benefits to receive the full benefits of both the systems. This action was taken over the objections of the entire membership of the Railroad Retirement Board and most of the railway labor organizations, including my own organization. It allowed the employees who qualified under both Railroad Retirement and Social Security to take advantage twice of the benefit formula "weighting" favoring lower income individuals. The result was that these people got a higher social security level benefit than persons with the same amount of total employment, all of which was performed under one system or the other. The Congress never completely funded the costs of the removal of the dual benefit restriction, as a result of which the unfunded portion of the payments thereby required became a direct drain on the Railroad Retirement Trust Fund. In 1974, the Congress removed the provisions for the dual benefit for the future but provided it had to be phased out through those in whom it had equitably vested. The 1974 Act authorized appropriations from general revenues for the phase-out of the dual benefits. The amounts authorized were to be sufficient to fund, on a level basis over the years 1976-2000, the dual benefit for new accruals and for beneficiaries on the rolls. It very soon became clear that the cost of the phase-out program was substantially more than the amount estimated and very substantially more than the funds appropriated by the Congress. The result was devastating to the Railroad Retirement Trust Fund. The Congress determined in 1974 that the costs of phasing out the dual benefits should be paid from appropriations to the general fund. Congress repeated that conclusion in 1981 and in 1983. In the latter year, it prohibited future payments of windfall benefits out of the railroad retirement account should there be a shortfall in appropriations from the general fund.

Significantly, in 1983, the OMB, through then Director Stockman, supported making the dual benefits a fully funded entitlement. Prior to that time OMB had consistently opposed federal funding for dual benefits but Congress, nevertheless, had provided such funding. Now OMB and the Administration want to burden the employees and the industry with further taxes to support in part at least these payments which the Congress historically and consistently assumed as a federal obligation. To accede to the Administration's request to this regard would be to contravene a Congressional policy established in 1974 and consistently followed thereafter. We respectfully submit that the Administration's request to burden the Railroad Retirement Account with 25% of the costs of the vested dual benefit payments be rejected.

We most appreciate the opportunity to appear before your Subcommittee and present our views on a subject so important to each of our active and retired members. I shall be happy to answer any questions that the members of the Subcommittee may have with regard to these issues.

Thank you.

Chairman JACOBS. Thank you, sir.
Mr. Dempsey.

**STATEMENT OF WILLIAM H. DEMPSEY, PRESIDENT AND CHIEF
EXECUTIVE OFFICER, ASSOCIATION OF AMERICAN RAILROADS,
AND CHARLES I. HOPKINS, JR., CHAIRMAN, NATIONAL RAILWAY
LABOR CONFERENCE**

Mr. DEMPSEY. Thank you, Mr. Chairman.

I am president of the Association of American Railroads, and Mr. Hopkins, who is with me, is chairman of the National Railway Labor Conference. He has responsibility for labor negotiations, and we do for legislation, and so we are here before you because that is a combined problem.

I will be very brief. We agree basically with the main point that Mr. Bates has made. But let me just say a couple of words about the two issues that you have before you.

The one is the increased taxes, or reduction of benefits, or whatever, to shore up the tier II Railroad Retirement Account, and the second is the imposition upon the industry, or employees, or whoever, of part of the cost of windfall dual benefits.

As to the first, as I say, I think what Mr. Bates said we thoroughly agree with. We have had labor negotiations on these issues now for many, many, many years, and the Congress, while of course exercising its prerogative to look at these matters independently, has certainly taken very seriously what labor and management have been able to agree to, and we have been able to agree in 1974 for a major revision, then in 1981 and 1983, and we need to have an opportunity to discuss these matters.

We have approached labor, we have had preliminary discussions, but we need more time to do that, and if the committee thinks that we ought to be under some kind of a timetable to make recommendations so far as we are concerned—and I am sure Mr. Bates would agree—we are glad to do that, but we need a chance to look at it. It is a serious problem. There is no question about that.

The tier II fund is in difficulty, and as the administration says, that is in large measure because of projections, actuarial projections that have gone awry, and why have they gone awry?

Well, that is not the chief actuary's fault. He is a very able man. But what we have here is a very small universe as opposed to Social Security. And we have got an industry that is beset by adverse economic forces, and so the projections that have been made, while at the time thought to be pessimistic, have turned out to be unduly optimistic probably.

Now, to what extent is wholly unclear at the present time. So, Congress needs more time, we need more time to look at the problem.

There is no short-term problem with respect to funding. As the chief actuary said, the fund in the next several years will continue to grow no matter what, just about.

The other thing that I would want to bring to your attention is that we are at about the upper limits of anything that any industry would consider reasonable in terms of retirement taxes. Here are the figures.

We have got, on the employers side, 24.65 percent of tier II taxable compensation as our retirement taxes. On the employees side, 13.83 percent of taxable payroll. That cumulates to 38.48 percent of taxable payroll going to the Railroad Retirement Account.

Now that is a staggering burden for the industry, and, if there is to be an additional burden—as there probably will have to be—that is to be allocated among the carriers, among existing employees, among future retirees, and among perhaps existing retirees, this will be a very, very difficult matter. And we just need more time to deal with it.

I am very grateful that labor is willing to come to grips with that with us, as they have been in the past. So that is I think essentially what I have to say about that part of it.

As to the windfall dual benefit matter, this thing has been raked over and raked over and raked over now since 1974. When we say dual benefits, of course what we mean is a railroad employee who gets both a Social Security benefit because he has worked, let's say, for General Motors, and a railroad retirement benefit because he has worked for the railroads. Now he might have been moonlighting or he left railroad retirement or whatever, but Congress had not coordinated those systems until 1974.

And so the result was that this dual employee, if you want to call him that, got a bigger benefit, Social Security benefit, to put it in a rough way, than the person who stayed in the rail industry for his whole life, or the person who moved from General Motors to Ford, or stayed in General Motors. It was unfair, there is no question about it.

The railroads opposed that system, and the unions did, as a matter of fact, at the start. And finally, in 1974, Congress coordinated the two systems so that cannot happen in the future, but they said, if an employee had vested rights under both systems he ought to be paid the dual benefit, but we will pay for it, the Federal Government will pay for it.

Because it is not the railroads' fault; it is not even due to railroad employment. It is due to General Motors' employment, or whatever other nonrail service there was, and so the Federal Government should bear that burden.

Since then there have been attacks on the side, one way or the other, to try to impose part of that burden on the employers, or maybe the employees, or whoever.

In 1974 the Congress knew the problem. They decided not to do that. In 1981 the question was raised by the Comptroller-General, and the Congress explicitly decided not to do it.

Last year it came up again, and we suggest that the Congress do what it has done in the past. The book ought to be closed on that one. Thank you, Mr. Chairman.

[The prepared statement follows:]

March 5, 1987

Before the
SUBCOMMITTEE ON SOCIAL SECURITY
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

JOINT STATEMENT ON PROPOSALS IN THE FISCAL YEAR 1988 BUDGET
RELATING TO THE RAILROAD RETIREMENT SYSTEM

by

WILLIAM H. DEMPSEY, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS

and

CHARLES I. HOPKINS, JR., CHAIRMAN, NATIONAL RAILWAY LABOR CONFERENCE

The Association of American Railroads represents almost all of the nation's class I railroads in a wide variety of matters, including legislative matters, that concern the railroad industry. The National Railway Labor Conference represents almost all of the nation's class I railroads in national collective bargaining with unions representing their employees and in regard to other matters concerning labor-management relations in the railroad industry, including negotiations with the unions upon joint recommendations to be made to the Congress for revision of the railroad retirement system. Hence, we are the principal officers of the two railroad associations that are directly concerned with legislation affecting the railroad retirement system. We are making this statement on behalf of those associations and their member railroads.

We have been advised to direct our comments to the proposals in the Administration's Fiscal Year 1988 Budget "to increase tier II taxes to improve the medium- and long-range outlook for the solvency of the railroad retirement pension fund," and "to introduce rail-sector financing of part of the cost of vested dual or 'windfall' benefits."

We share the concern about the medium- and long-range outlook in regard to the financial solvency of tier II of the railroad retirement system, but we urge that action by the subcommittee at this time upon the proposed tax increase would be premature. First, no one suggests that there is or will be an immediate financial crisis over at least the next five years. Second, labor and management should be given an adequate opportunity to discuss this complex matter. Tier II generally is the equivalent in the railroad industry of collectively-bargained private pension plans in other industries; railroad labor and management traditionally have bargained and agreed upon joint recommendations for revisions that, among other things, fairly share the burden of resolving threats to the future solvency of tier II that are apparent at the time; and the Congress heretofore has given great weight to those recommendations. Railroad labor and management already have initiated discussions in regard to such joint recommendations, but the problem is a difficult one and more time is needed before we can agree upon a program to recommend to the Congress. We suggest, therefore, that the parties be given a reasonable time in which to negotiate upon such joint recommendations.

The railroads oppose outright the proposed change in the method of financing windfall dual benefits. The solution to the "windfall" problem adopted by the Congress when it enacted the Railroad Retirement Act of 1974, including the financing out of the general fund of the costs of phasing out such benefits, essentially was reconfirmed by the Congress in 1981 and 1983. That issue should be regarded as settled. The Congress did not adopt this proposal as made in the Administration's FY 1987 Budget and it should not do so now.

We explain below in more detail our position with regard to each of those proposals.

The Proposed Increase in Tier II Taxes

Tier I of the railroad retirement system essentially is equivalent to social security in other industries, including tier I taxes imposed by the Railroad Retirement Tax Act (Chapter 22 of the I.R.C.) identical to social security taxes. Thus, both the railroads and their employees now pay tier I taxes at the rate of 7.15% of taxable compensation, which rate is scheduled to increase to 7.51% in 1988 and to 7.65% in 1990. 26 U.S.C. §§ 3201(a) and 3221(a). Tier II of the Railroad Retirement Act of 1974 provides old-age and disability benefits to retired or disabled railroad employees, their spouses and survivors (over and above the tier I or social-security equivalent benefits) that generally are similar to benefits afforded in other industries under collectively-bargained private pension plans. See 45 U.S.C. §§ 231 *et seq.* Those benefits primarily are financed out of tier II taxes imposed under the Railroad Retirement Tax Act at the rate of 14.75% of taxable compensation in regard to employers and 4.25% of taxable compensation in regard to employees. 26 U.S.C. §§ 3201(b) and 3221(b). In addition, the railroads alone pay a supplemental tax fixed quarterly by the Railroad Retirement Board at an amount "for each man-hour for which compensation is paid" sufficient to fund the cost of certain supplemental tier II benefits paid to retired long-term employees. 26 U.S.C. § 3221(c). That amount is now fixed at 24 cents per man-hour.

In 1987, taxable compensation is subject to a \$43,800 maximum in regard to the tier I tax and to a \$32,700 maximum in regard to the tier II tax. The combined tier I and tier II taxes payable in 1987 by the railroads amount to 22.61% of taxable compensation under tier II and the supplemental tax amounts to another 2.04%, for an overall percentage of 24.65% of tier II taxable compensation. The combined tier I and tier II taxes payable by railroad employees in 1987 amounts to 13.83% of tier II taxable compensation. The total for the railroad industry in 1987 thus comes to 38.48% of tier II taxable compensation. Those figures speak for themselves. They make it obvious that railroad retirement taxes have reached the extreme upper limits of what is reasonably bearable. Any proposal for a further increase calls for thorough and careful consideration before the Congress acts.

Nonetheless, the Administration proposes to increase tier II railroad retirement tax rates by 1.5% effective January 1, 1988 and by an additional 1.5% effective January 1, 1989. This is said to be necessary to "protect the solvency of the fund," as "[f]inancing legislation for the rail industry pension fund enacted in 1974, 1981, and 1983 was based on what has proven to be optimistic assumptions, and Railroad Retirement Board actuaries now recommend measures equivalent to raising rail pension contributions" by those amounts. FY 1988 Budget at 2-40.

The Administration in its Budget did not indicate how the proposed tax increases should be allocated, but has since urged that they should "be shared by the employer and the employee." February 4, 1987 Statement to the Senate Finance Committee by Assistant Secretary of the Treasury for Tax Policy J. Roger Mentz at page 12. In oral testimony, Mr. Mentz further stated that the sharing should be on a fifty-fifty basis as between employers and employees. Moreover, as stated in the above paragraph that tax proposal is based on "recommendations by Railroad Retirement Board actuaries" We understand that statement to refer to a report from the Board's Chief Actuary setting forth his technical views and recommendations to the Board, enclosed with the Board's June 27, 1986 Report to the Congress pursuant to § 502 of the Railroad Retirement Solvency Act of 1983 (P.L. 98-76). Among other things, the Chief Actuary states in his report (at p. 5) that:

"This report contains no recommendations regarding the relative proportion of the burden of additional financing which should be borne by railroad employers, employees and beneficiaries. The recommendation which follows [for two 1.5% increases] is stated in terms of tax increases, but this is not meant to exclude the possibility of reducing any necessary tax increase by adjusting benefits. Congress may find it appropriate to allow railroad labor and management to prepare joint recommendations regarding the proportion of any tax increase to be borne by employers, the proportion to be borne by employees, and what, if any, adjustments are to be made in benefits."

The suggestion by the Chief Actuary that the "Congress may find it appropriate to allow railroad labor and management to prepare joint recommendations" accords with the past practice of the Congress as well as with common sense. Among other things, the major restructuring of the railroad retirement system enacted by the Railroad Retirement Act of 1974 (which replaced the Railroad Retirement Act of 1937) was based in large measure upon joint recommendations of a labor-management negotiating committee, established pursuant to specific directions of the Congress to make such recommendations (see 86 Stat. 767, 87 Stat. 165) in the light of a report of a Commission on Railroad Retirement previously established by the Congress (84 Stat. 792-794). That Commission included representatives of railroad labor and management and was directed to make a study of the system and recommend changes to provide an adequate level of benefits on an actuarially sound basis. So, too, the less far-reaching revisions in 1981 and 1983 to which the Administration refers were based in large measure upon joint recommendations by railroad labor and management agreed upon in more informal negotiations.

It essentially is true that, as the Administration has stated in its Budget, the legislation "enacted in 1974, 1981, and 1983 was based on what has proven to be optimistic assumptions," although that "proof" involves further actuarial predictions of future occurrences which necessarily cannot be hard and fast. This is not because the actuarial assumptions made at the time intentionally were optimistic or misleading. Rather, the recommendations made by railroad labor and management in 1974, 1981 and 1983, and the legislation enacted by the Congress, were based upon the best actuarial advice available, including that of the Chief Actuary of the Railroad Retirement Board, in the light of what were then thought to be prudently pessimistic assumptions. Indeed, as recently as the 1985 § 502 report, included in the Board's Sixteenth Actuarial Valuation, the Chief Actuary -- while not foreclosing questions as to the long-term stability of the railroad retirement system -- did not see any need to recommend an adjustment in tier II tax rates as "even substantial declines in employment

will not bring about cash-flow problems" in the "next 10 to 20 years," and concluded that it was "feasible to divert a portion of employer taxes to the Railroad Unemployment Insurance Account to aid in the repayment of its debts to the Railroad Retirement Account." See Sixteenth Actuarial Valuation, Part C, at 2-3.

We emphasize that we do not intend to criticize or blame the Board's Chief Actuary or prior occupants of that position. In our opinion, they have performed a difficult and demanding role as well as reasonably could be expected. The problem is not in the Actuary but in the nature of actuarial predictions. They necessarily involve assumptions as to future occurrences about which no one can be certain in advance of the fact. In particular, actuarial predictions regarding the future financial status of the Railroad Retirement Account are strongly influenced by assumptions regarding future railroad employment. Apart from short-term fluctuations, railroad employment has been declining for many years. For example, in 1937 when the Railroad Retirement Act of 1937 was enacted, railroad employment averaged 1,279,000; in 1974 it averaged 592,000; in 1981 it averaged 503,000; in 1983 it averaged 395,000; and in 1986 it averaged 338,000. While further declines seem inevitable, it also seems inevitable that the recent rate of decline in employment must eventually abate if the railroad industry is to continue to exist. The difficult problems are to predict when that will occur and what declines will occur in the interim. The reversal between the 1985 report and the 1986 report in the recommendations made by the Chief Actuary primarily is attributable to changes in his future employment assumptions.

As the Chief Actuary noted in his 1986 § 502 report, for purposes of his 1985 report, his A (least pessimistic), B (intermediate) and C (most pessimistic) valuations assumed that "employment would decline from its 1984 level by two percent, three percent and four percent annually, respectively, through 2000," which "rate of decline was assumed to decrease in later years." Thus, the assumed employment levels in 2010 were 255,000 under Valuation A, 205,000 under Valuation B, and 163,000 under Valuation C. See Report at 1. Given those assumptions, under Valuation A, "an actuarial surplus existed and no cash-flow problems arose throughout the projection period," and under Valuations B and C cash-flow problems would not arise until 2014 or 2005, respectively. See Report at 5. However, in view of the sharp decline in employment in 1985, when no economic recession was in progress to account for the decline, the Chief Actuary concluded that he should lower the 1986 base to 343,000 and assume future annual declines at the rate of 3.5%, 4.0% and 4.5% for Valuations A, B and C, respectively. This resulted in assumed employment levels in 2010 of 146,000 as to Valuation A, 129,000 as to Valuation B, and 114,000 as to Valuation C. See Report at 2-3 and 7. Those assumed levels are 43%, 37% and 30% lower, respectively, than the employment levels for 2010 assumed in the 1985 report. These revised employment assumptions further resulted in actuarial predictions that the Railroad Retirement Account will run out of funds in 2007 under Valuation A, in 2005 under Valuation B, and in 2003 under Valuation C. See Report at 4, 8-10.

We are not prepared to say at this time that those revised employment assumptions are unjustified. While it obviously is true, as stated by the Chief Actuary on page 5 of his 1986 § 502 report, that "[n]o one can be certain that these declines will materialize," significant further declines in employment during at least the next few years appear to us to be probable. If the railroads are to compete successfully in today's competitive environment, they must significantly increase productivity by all available means, including elimination of unneeded manpower. Even if that is done, we do not foresee any significant increases in rail traffic in

view of expanding low-rate truck and barge competition. If that is not done, loss of business may well lead to even larger reductions in employment. Hence, we believe that the Chief Actuary has identified a serious long-term problem in regard to the financial condition of the Railroad Retirement Account which should be addressed within the relatively near future.

However, as the Chief Actuary recognized in his 1986 report (at p. 5), "the railroad retirement system's fund is expected to continue growing for several years without new legislation, even under the most pessimistic employment assumption," and there "is no immediate danger of having to curtail benefits in the absence of additional financing." Thus, there is ample time to follow his suggestion, which we strongly endorse, that the "Congress may find it appropriate to allow railroad labor and management to prepare joint recommendations regarding the proportion of any tax increase to be borne by employers, the proportion to be borne by employees, and what, if any, adjustments are to be made in benefits."

Neither the Chief Actuary nor the Administration has recommended how that allocation should be made although -- as noted above -- the Administration has urged that its proposed tax increases be shared equally between employers and employees. A fair allocation of the burden between tax increases for employers, tax increases for employees, and benefit adjustments (as occurred, for example, in 1983) obviously is a most difficult problem involving conflicting interests that require careful consideration. Certainly, consideration should be given to adjustments in the benefits payable to future retirees as well as to the tier II taxes paid by the railroads and by their employees. Moreover, one result of prior actuarial assumptions that have "proven to be optimistic" is that benefits for retirees on the rolls were set at levels that may now be thought to be unjustifiably high in view of subsequent experience. In addition, a significant portion of the long-term financial problems of the Railroad Retirement Account were caused by the federal government. Although the Congress in enacting the Railroad Retirement Act of 1974 concluded that it primarily had been at fault in providing so-called "windfall" dual benefits, over the opposition of the railroads and initially of the unions, and remedied that problem for the future, the payment of such benefits already had cost the Railroad Retirement Account in excess of \$4 billion dollars. See p. 6 *infra*. That loss, which continues to grow because of lost interest, never has been made up to the Account. There also have been other occasions in which benefits have been imposed or increased in response to political pressures, rather than to labor-management agreement.

In view of all these complex considerations, it may even be desirable to have another thoroughgoing restructuring of the railroad retirement system based upon an in-depth study such as the study by the Commission on Railroad Retirement that preceded the enactment of the Railroad Retirement Act of 1974. At present, however, we urge only that railroad labor and management be given more time to come up with joint recommendations as to the financing of tier II railroad retirement benefits. While some informal initial discussions have been had, efforts to complete the current round of national wage and rules negotiations have been all-absorbing. Much more intensive discussions of railroad retirement are needed.

The Proposal for Partial Rail-Sector Financing of the Costs of "Windfall" Benefits

The Administration has proposed "having the rail sector finance 25 percent of Federal windfall subsidy costs." FY 1988 Budget Supplement at 5-119. It proposes that this be done through a rider to the appropriations

to the Dual Benefits Payments Account under which \$276 million would be appropriated to that Account out of the general fund and an additional \$92 million "shall be derived from the rail pension fund"; i.e., from the Railroad Retirement Account that is funded from the tier II taxes paid by the railroads and their employees. See FY 1988 Budget Appendix at I-Z 81 and 82. That proposal is said to be based upon a finding by the General Accounting Office "that rail industry funded pensions are reduced by some 25 percent of windfall amounts," and a suggestion by GAO "that it may be more accurate to subsidize only 75 percent of total windfall costs." FY 1988 Budget Supplement at 4-20.

The same proposal with the same justification was included by the Administration in its Fiscal Year 1987 Budget (at 4-10). It was not adopted by the Congress last year and it should not be adopted now.

In essence, a "windfall" dual benefit amount is the amount by which the total of the tier I railroad retirement and social security benefits payable to an individual, who qualified under both systems, exceeds the total amount that social security would pay if that system also covered railroad employment. This excess amount resulted from the fact that, prior to the Railroad Retirement Act of 1974, the Congress had not coordinated the computation of the two benefits. Application of the social security benefit formulas separately to railroad and non-railroad employment produced a greater combined amount than would application of those formulas to combined employment. While the 1974 Act eliminated that problem for the future, the Congress concluded that individuals who had established a vested right to a windfall amount should continue to be paid that amount. See H. Rept. No. 93-1345 (1974) and S. Rept. No. 93-1163 (1974) at 1-13.

The Congress also determined in 1974 that the full amount of the costs of thus phasing out windfall dual benefits should be paid through appropriations from the general fund. See H. Rept. No. 93-1345 and S. Rept. No. 93-1163 at 2-11. Among other things, the "railroads had no part in the creation of the current situation" and the windfall benefit arose "out of non-railroad employment . . . which has not benefitted the railroad industry in any fashion," so that "it would be unfair to the railroad industry to saddle the carriers with the cost of phasing out dual benefits." H. Rept. No. 93-1345 and S. Rept. No. 93-1163 at 4. That is particularly true since the payment of windfall benefits prior to enactment of the 1974 Act had cost the railroad retirement system "in excess of \$4 billion," which was paid out of railroad retirement taxes and has never been reimbursed to the system. See H. Rept. No. 93-1345 and S. Rept. No. 93-1163 at 2-3. In thus providing for payment out of the general fund of the costs of phasing out windfall benefits, the Congress was aware that the tier II benefit formula provided for a partial offset of the windfall amount against the tier II benefit otherwise payable -- as had been done under the Railroad Retirement Act of 1937. See H. Rept. No. 93-1345 and S. Rept. No. 93-1163 at 34.

On March 9, 1981, the Comptroller General transmitted to the Chairman of the House Committee on Government Operations a GAO Report -- entitled "Keeping the Railroad Retirement Program on Track - Government and Railroads Should Clarify Roles and Responsibilities" -- in which GAO noted that offset and suggested that it might justify a concomitant reduction in windfall appropriations (Report at 31-34). Nonetheless, later that year, in the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35), the Congress adopted amendments to the Railroad Retirement Act of 1974 that, among other things: (1) revised the tier II benefit formula, but in so doing retained and specifically provided for a reduction of the basic tier II amount "by 25 per centum of the amount computed" for the individual under the windfall provisions; (2) established a separate Dual Benefits Payments Account for the payment of windfall benefits; and (3) limited the total amount of such

payments in a fiscal year to the amount appropriated by the Congress for that purpose. See 95 Stat. 630, 638-639; H. Rept. No. 97-208 (Conf. Rept. 1981) at 861, 866-867.

The establishment of a separate Dual Benefits Payments Account and the limitation of such payments to the amounts appropriated therefor, was attributable to the fact that -- while the Congress in the 1974 Act had authorized and intended that the costs of phasing out windfall benefits be paid from appropriations from the general fund -- the actual appropriations had fallen short of the necessary amount, which created an unintended drain upon the Railroad Retirement Account as funded by tier II taxes. The Congress in 1981 did not make up for the shortfall during the 1975-1981 period, but it did so with interest as a part of the amendments to the Railroad Retirement Act of 1974 adopted in the Railroad Retirement Solvency Act of 1983 (P.L. 97-76). See 97 Stat. 433-434; H. Rept. No. 98-30 (Pt. 1, 1983) at 20-21, 26, 29, 41.

In H. Rept. No. 98-30, *supra* at 20, it was noted, among other things, that the Congress in the 1974 Act intended "for the cost of dual benefits . . . to be reimbursed out of general revenues;" the failure of OMB "to ask for sufficient funding" resulted in a shortfall that "was in effect, being financed through the Tier II tax, contrary to the clear intent of the 1974 Act;" that even after the 1981 Act "OMB continued to oppose full funding" which initially resulted in a cut in windfall benefit payments until such funding was restored by the Congress in appropriations from the general revenues; and that:

"On March 1, 1983, in testimony before the Subcommittee on Commerce, Transportation and Tourism, OMB Director Stockman testified that he supported making the dual benefit a fully-funded entitlement. The Committee is pleased that the Administration has finally agreed with the Congress that earned benefits to retirees should not be cut."

Nevertheless, despite that history and the 1983 testimony by Director Stockman supporting full funding of the costs of phasing out windfall benefits through appropriations from general revenues, OMB and the Administration once again are proposing that a part of those costs be financed "through the tier II tax" which, as H. Rept. No. 98-30 stated, is "contrary to the clear intent of the 1974 Act." That intent of the Congress was reaffirmed in 1981 and in 1983. It in effect was reaffirmed last year when the Congress ignored a proposal in the FY 1987 Budget identical in all respects to the proposal in the FY 1988 Budget now being considered by this Subcommittee. That proposal would depart from a resolution of the windfall benefit problem that the Congress established in 1974 and has repeatedly reaffirmed. The proposal once again should be rejected.

Conclusion

We appreciate this opportunity to appear before the Subcommittee and express the views of our respective associations and their member railroads in regard to the foregoing proposals in the FY 1988 Budget. We shall be pleased to respond to any questions that members of the Subcommittee may have in regard to these matters.

Chairman JACOBS. Have you a statement, sir?

Mr. HOPKINS. I have nothing to add to what Mr. Dempsey has said.

Chairman JACOBS. Fine.

Mr. Daub.

Mr. DAUB. Mr. Chairman, thank you very much. I appreciate your testimony. I am interested. Omaha, Nebr., has got lots of rail labor in it and lots of railroad activities, as does our State.

Actually, Mr. Chairman, if I might just take the prerogative to ask one question that is not on the subject, but having missed the Board's testimony I will write each of them a letter to get their answer to my question. But, they are here to hear it, and might even want to be a volunteer and save the Government the postage. Beverly Byron and Bill Goodling, and Nick Rahall and I have introduced a last-person service bill again this year, and just a quick "yes" or "no" on whether you think we ought to do something about that.

Mr. DEMPSEY. I have not seen the bill. I am sorry.

Mr. DAUB. You have not seen the bill. Last year the bill number was H.R. 1550, and it is an attempt to modify that last-person service rule where the person has benefits, maybe he does not take them, gets a part-time job and then finds out that he has to quit one job in order to get benefits.

Mr. DEMPSEY. Yes. Well, my recollection—and Mr. Hopkins will correct me if I am wrong—is that we have a tentative understanding with the unions on that issue. But I would have to look at that bill again.

Mr. DAUB. Let us know, will you?

Mr. DEMPSEY. Yes, surely.

Mr. JACOBS. Mr. Archer is generically the cochairman of this subcommittee. Mr. Archer.

Mr. DEMPSEY. It is in the bill, Mr. Bates reminds me.

Mr. BATES. It was in the unemployment benefit.

Mr. DAUB. It was and it did not get consideration in the Ways and Means Committee. It died there, if I recall, last year.

Mr. DEMPSEY. Well, in that form—

Mr. DAUB. In that form you do support it?

Mr. DEMPSEY. Yes, sir.

Mr. DAUB. We track on that in the new legislation that is being introduced.

Mr. BATES. Has that not been reintroduced just in the last couple of days?

Mr. DAUB. Yes, and the bill number is H.R. 1148 this session. Thank you. Mr. Chairman, thank you.

Chairman JACOBS. Thank you. Bill.

Mr. ARCHER. Mr. Dempsey, you mentioned the very high tax on payroll in the railroad industry, and it is extremely high. What is the reason for that?

Mr. DEMPSEY. Well, I guess there are always two reasons for that sort of thing. Basically, one is that our retirement benefits are high, and the other is that our employment is declining.

When we are talking about a tax on payroll, of course it is not the full payroll. We are talking about a \$32,700 maximum payroll, taxable payroll for tier II, and our figures are geared to that.

When you look at our industry, the fact of the matter is that our employment has come down—now Mr. Hopkins would have these figures I am sure right on top of his head. Do you have them, Chuck?

Mr. HOPKINS. It was about a million, three when the Railroad Retirement Act was passed, and now it is down to approximately 300,000.

Mr. DEMPSEY. So what we have got is a Social Security problem in spades. They have got something like one beneficiary for every two-plus employees. The railroads have got three beneficiaries for every one active employee, and so those are the numbers.

Mr. HOPKINS. We have nearly a million beneficiaries.

Mr. ARCHER. Well, then, I would interpret from what you have said that there was an inadequate tax on employer and employee during most of the work lives of the people who are currently retired, and that that burden is now being placed on the current workers, because it was inadequately funded over the last 50 years.

Mr. DEMPSEY. Well, if you—

Mr. ARCHER. Because declining employment does not injure a retirement system if it has been adequately funded during the work lives of those who are retired.

Mr. DEMPSEY. Yes. If you fund it on ERISA terms, that is right. If you fund it, though, the way that Social Security is funded, and the way that the Railroad Retirement System has been funded, it essentially is on kind of a pay-as-you-go basis.

And so, you know, you look ahead 10 or 20 years but you do not fund it 50 years or 75 years ahead of time, as you do under ERISA.

So I do not disagree with what you say, Congressman, except that that is not the way that this system—

Mr. ARCHER. I see, I just wondered where management and union were all those many years when we should have been adequately funding it and nobody really seemed to stop and say, hey, a day of reckoning is coming.

Mr. DEMPSEY. I know, and I appreciate what you are saying, and I have got to say that I bear some burden on that because I have been involved in this since the 1974 act was passed, and the actuarial projections, I can assure you, that were made by the Board's chief actuaries, all along, have been made completely honestly and with a view toward pessimism rather than optimism.

You have to look at our industry and see what has happened to it. We have had terrible times. The 1970's was just a decade of chaos and disaster. We had the whole Northeast go smash. We had the Milwaukee Road split in two. We had the Rock Island wiped out.

And you know, when you are looking at that kind of a catastrophe to an industry with, as I say, a pretty narrow universe, you know, the projections that are made along there are just bound to be inaccurate as they come out.

Mr. DAUB. Will the gentleman yield.

Mr. ARCHER. I will be happy to yield.

Mr. DAUB. I appreciate the gentleman's point. I look at a system that is essentially pension-oriented as opposed to the defined, or Social Security system, and the way we attempted to look ahead to pay for it. And then look at the add-on of the widow, and survivor

and orphan benefits, if you will, to that pension package, and then just plain look at life expectancy tables on top of the devastation that has occurred to railroads.

In the railroad industry, particularly, I think, we had a limited field to begin with. Then you start trying to figure out on life expectancy tables for the surviving widow, or widower, and that has caused a real hemorrhage problem. You are right, Mr. Archer, we did not really contemplate and take into account very well during the 20 years before this time.

Mr. ARCHER. Thank you, Mr. Chairman.

Chairman JACOBS. I have only one question.

Does any member of the panel know—I believe, Mr. Dempsey, you mentioned a figure of 38 percent—what percent of payroll are your retirement costs?

Mr. DEMPSEY. The total is 38.48 percent, employer and employee.

Chairman JACOBS. 38.48?

Mr. DEMPSEY. Yes.

Chairman JACOBS. Does anybody know what the comparable figure is for military retirement now? What percent of payroll? Does anybody on this panel know?

[No response.]

Chairman JACOBS. Well, I think when our friend Bob Myers reaches the table, he will relieve that problem for us, and I thank the panel. The committee thanks the panel for your participation. You have enriched the record.

Will the next panel please come forward.

While the panel is being seated, I know I speak for the subcommittee in expressing our special pleasure at seeing our old friend Bob Myers, our good friend and our good teacher here today.

Mr. MYERS. Thank you, Mr. Chairman. I am glad to be here.

Chairman JACOBS. Is Mr. Butts present? Aren't you on this panel, sir?

I wonder, then, if Mr. Fontaine would proceed at this time and then Mr. Myers and then Mr. Butts.

Mr. Grisanti is in a taxicab someplace, probably in this city, on his way here. So we will see if he gets here on time; otherwise, his statement will be received for the record.

Please proceed, Mr. Fontaine.

**STATEMENT OF DOUGLASS FONTAINE, OWNER AND MANAGER,
LAFONT INN, PASCAGOULA, MISS., ON BEHALF OF THE AMERICAN
HOTEL & MOTEL ASSOCIATION**

Mr. FONTAINE. Good morning. I am Douglass Fontaine, owner and manager of the LaFont Inn located in Pascagoula, Miss.

I am appearing here today on behalf of the membership of the American Hotel & Motel Association. We appreciate the opportunity to appear before the Social Security Subcommittee on the House Ways and Means Committee and offer testimony on requiring employers to pay FICA tax on employee tips.

In his recently released budget document, the President included a proposal requiring employers to pay the so-called "employer portion" of the Social Security payroll tax on total tips received by employees.

The President's budget predicted receipts of \$200 million for this line item for fiscal 1988.

The lodging industry generated over \$42 billion in sales in 1985 with approximately \$14.5 billion representing food and beverage sales which may have generated tip income for tipped employees of hotels and motels.

The employer portion of Social Security tax on that figure for our industry alone would be a staggering \$83 million for 1985.

We are opposed to this targeted tax increase. Personally, in my own property, it would cost me an additional \$7,000 a year. Coming from a community that is having 14 percent unemployment, we cannot pass this along to our customers.

We are in tough economic times in our industry in our section of the country, and this would require us to further add to the unemployment picture that we have got in our community.

An administration witness testifying recently before the Senate Finance Committee on this proposal called the current system a "quirk in the law." A review of the legislative history of the 89th Congress subjecting tips to employee FICA shows that serious consideration was given to this question.

An effort to tax both employer and employee at the applicable rate as the President now proposes was rejected in that conference. In rejecting an employer's Social Security tax on employee tips, the conference report states: Thus, tips are not considered as remuneration for employment for the purposes of the employer taxes.

The fact that tips are not wages was obviously a significant reason for exempting the employer from the FICA on tips. That fact has not changed today: Tips are not wages. They form no part of the payroll of the employer. Payroll has always consisted of amounts actually paid as wages by the employer to the employee and over which the employer has exercised full control.

If Congress obligated an employer to make a FICA payroll tax payment on tips, the employer would be unable to control the maximum amount attributable to payroll. In addition, the employer would have no way of knowing in advance the amount the liability for such a tax and would be denied the opportunity to plan for and schedule such payments.

The Congress showed great wisdom in 1965 when it determined the method of assessing FICA on tips. That method works because it actually identifies tips as what they are: nonwage income flowing from employment.

The fact that tips are income flowing from employment makes it appropriate to subject the employee to FICA on these amounts. The fact that these amounts are not wages, not in any way paid or controlled by the employer, makes it appropriate to exclude the employer from the payment of FICA on these items.

It is common knowledge that the recent amendments to the Social Security law restored solvency to the system. The solvency is projected to run well into the 21st century.

Also under the current system, beneficiaries paying FICA tax on tip income receive full benefits. Causing the employer to pay the proposed additional amounts in no way enhances the Social Security benefits receivable by tipped employees.

This tax increase contradicts promises from the administration and Congress that tax increases would not follow on the heels of the Tax Reform Act of 1986. We call on Congress not to do indirectly what it has promised not to do directly. This is not only unfair; it is unnecessary.

We call on the Ways and Means Committee to reject the lure of the subsidy argument and see the current assessment of FICA on tips as the fair, correct, and equitable way to determine that liability. No modification is needed.

I will be pleased to answer any questions.

[The prepared statement follows:]

STATEMENT OF DOUGLASS FONTAINE, OWNER/MANAGER, LAFONT INN,
PASCAGOULA, MISSISSIPPI, ON BEHALF OF THE AMERICAN HOTEL
& MOTEL ASSOCIATION

I am Douglass Fontaine, Owner/Manager of the LaFont Inn located in Pascagoula, Mississippi and I am appearing here today on behalf of the membership of the American Hotel & Motel Association. We appreciate the opportunity to appear before the Social Security Subcommittee of the House Ways and Means Committee and offer testimony on requiring employers to pay FICA tax on employee tips.

The American Hotel & Motel Association is a federation of hotel and motel associations located in the fifty states, the District of Columbia, Puerto Rico and the Virgin Islands. The Association has a membership of over 8,800 individual hotels and motels which represents approximately 1.28 million rentable rooms. Inclusive in our membership are all of the major hotel and motel chains. However, the majority of our members are smaller properties. Based on 1985 figures, the lodging industry employs on the average 1,400,000 people with an annual payroll exceeding \$12.2 billion. In addition, the lodging industry pays over \$4.1 billion in federal taxes annually. In 1985 alone, the lodging industry created over 100,000 new jobs.

The lodging industry generated over \$42 billion in sales in 1985 with approximately 25% of that total or \$10.5 billion generated by food sales and 9.5% or \$4 billion generated by beverage sales. This combined total of \$14.5 billion represents sales which may have generated tip income for tipped employees of hotels and motels. While many factors affect the percentage tip which may be received in a particular situation, if we were to apply, for example, a rate of 8% as is done in IRS Tip Allocation Regulations, that percentage would have generated total tips on food and beverage sales of \$1.16 billion in 1985. The employer portion of Social Security tax on that figure for our industry alone would be a staggering \$83 million for 1985.

In his recently released budget document, the President included a proposal requiring employers to pay the so-called "employer portion" of the Social Security payroll tax on total tips received by employees. The President's budget predicted receipts of \$200 million for this line item for fiscal '88. We are opposed to this targeted tax increase.

An Administration witness testifying recently before the Senate Finance Committee on this proposal called the current system a "quirk in the law". A review of the legislative history of the 89th Congress enacting the amendments to the Social Security law subjecting tips to employee FICA shows that serious consideration was given to this question by both the House and Senate. The decision that was reached, to have only the employee pay Social Security tax and to pay only at the employee rate, was a compromise position reached in the Conference on the 1965 Amendments to Social Security (Rept. No. 682, 89th Congress, 1st Session). An effort to tax both employer and employee at the applicable rate as the President now proposes was rejected in that Conference. In rejecting an employer's Social Security tax on employee tips, the Conference Report states "Thus, tips are not considered as remuneration for employment for purposes of the employer taxes..."

During that Congress, the Senate passed legislation requiring employees to pay Social Security taxes on tips at the self-employment rate. While we agree that this would be the appropriate tax treatment in light of the nature of tips, we have no desire to see the employee pay higher FICA taxes at this time, because we reject the concept of any present increase in Social Security tax.

The simple truth in the above quotation from the Conference Report, that tips are not wages, was obviously a significant reason for exempting the employer from FICA on tips. That fact has not changed today -- tips are not wages. They form no part of the payroll of the employer. Payroll has always consisted of amounts actually paid as wages by the employer to the employee and over which the employer has exercised full control. This control is necessary to allow the employer to determine the total payroll that can be afforded, and to plan in advance to meet the necessary payments for salaries, fringe benefits and all state and federal taxes related to payroll. If Congress obligated an employer to make a FICA payroll tax payment on tips, the employer would be unable to control the maximum amount attributable to payroll. In addition, the employer would have no way of knowing in advance the amount of the liability for such a tax and would be denied the opportunity to plan for and schedule such payments.

To take monies given to an employee by an unrelated third party and create a liability for an employer based on such amounts defies logic and common sense. The Congress showed great wisdom in 1965 when it determined the method of assessing FICA on tips. That method works because it accurately identifies tips as what they are: non-wage income flowing from employment. The fact that tips are income flowing from employment makes it appropriate to subject the employee to FICA on these amounts. The fact that these amounts are not wages, not in any way paid or controlled by the employer, makes it appropriate to exclude the employer from payment of FICA on these items. It is bad legislative policy to disturb a FICA tax arrangement which accurately assesses liability for FICA tax on tips merely to obtain an increase in general revenues. This does an injustice to the Social Security system and such tinkering should be flatly rejected.

It is common knowledge that the recent amendments to the Social Security law restored solvency to the system. The System now is a "pay-as-you-go" system running in the black. This condition of solvency is projected to run well into the 21st century. In simple words, Social Security does not need additional money. Under the current system, beneficiaries paying FICA tax on tip income receive full benefits. Causing the employer to pay the proposed additional amounts in no way enhances the Social Security benefits receivable by tipped employees. Revenues raised under the banner of Social Security would become part of the general revenues.

With any monies flowing from an employer FICA tax on tips not benefitting the Social Security system or any class of beneficiaries the question arises what has the Administration proposed.

The answer is evident, a tax increase, plain and simple - targeted at the lodging/restaurant industry. This contradicts promises from the Administration and Congress that tax increases would not follow on the heels of the Tax Reform Act of 1986. We call on Congress not to do indirectly what it has promised not to do directly. The lodging industry, in particular, felt the pain of Tax Reform last year. It suffered and will continue to suffer along with many other industries. Now our industry is being targeted again by employer-paid FICA on tips for an additional tax payment that may exceed \$80 million annually. This is not only unfair, it is unnecessary.

There is an additional word of caution. It seems clear that the ultimate payor in this scheme may be the consumer. With the employer having no control over or access to tips, if he is required to pay the FICA tax on tips, these payments will

directly reduce the profit of the business. This loss may be passed on to the consumer in an amount sufficient to pay not only the FICA tax but the income tax on the revenue increase. In the alternative, if the practice of imposing a service charge becomes more prevalent the consumer may pay even more because history shows us that when a service charge is imposed many still continue to tip. This, directly increases the cost to the consumer.

We call on the Ways and Means Committee to reject the lure of the "subsidy" argument and see the current assessment of FICA on tips as the fair, correct and equitable way to determine that liability. No modification is needed.

Chairman JACOBS. Thank you, sir.

Our next person in line is Mr. Butts. Mr. Levin has arrived, so why don't you proceed according to schedule.

STATEMENT OF THOMAS BUTTS, ASSISTANT TO THE VICE PRESIDENT FOR ACADEMIC AFFAIRS, UNIVERSITY OF MICHIGAN, ON BEHALF OF THE AMERICAN COUNCIL ON EDUCATION

Mr. BUTTS. Thank you, Mr. Chairman, members of the committee. I am Thomas Butts, assistant to the vice president for academic affairs at the University of Michigan. I previously——

Chairman JACOBS. Excuse me, Mr. Butts.

Did you want to read this gentleman's pedigree, Mr. Levin, into the record?

Mr. LEVIN. It speaks for itself. We chatted recently. We just welcome the distinguished representative of the University of Michigan.

Chairman JACOBS. I am sorry. I did not mean to trample on the privileges of Members. Please.

Mr. BUTTS. Thank you very much, Mr. Levin.

I welcome the opportunity to comment on the administration's fiscal year 1988 budget request to eliminate the 48-year-old law which excludes students employed at educational institutions from Social Security taxation.

A copy of the statement of the American Council on Education on behalf of 13 higher education associations is attached to my comments. I would like to let you know that the U.S. Student Association and the National Student Roundtable have asked to be identified with our remarks.

We have serious reservations about the wisdom of ending the section of the code which, since 1939, has permitted educational institutions and students employed by them to focus their resources on education.

The administration's rationale for extending coverage to students is based on the belief that institutions were once exempt because of the administrative burden withholding would cause. Now that institutions have the capability to withhold, they argue that the exemption is no longer necessary.

It is true that the burden is no longer administrative; it is financial. It would cost the University of Michigan an estimated \$2.6 million in 1987 to pay the 7.15 percent match on its temporary student payroll. Over 19,000 students who are working in order to help meet college expenses would have their wages reduced by a like amount. We are not alone. I learned this morning that Purdue would be similarly affected at a rate of \$2.6 million. The University of California would have to find \$12.8 million to meet the employer contribution.

I am sorry that I can only provide anecdotal data on the effects this proposal would have on higher education. It frankly caught us by surprise and, to the best of our knowledge, has not been subjected to serious national policy analysis.

Last week, the Assistant Secretary for Postsecondary Education was asked at an appropriations hearing whether the Education Department had been consulted about the effects this proposal might

have on the availability of student financial aid and the Department's programs. He had not heard of the proposal. He did acknowledge that this plan would affect programs for which he is responsible. For example, it would have the effect of reducing the appropriation for the College Work Study Program by 7.15 percent or up to \$42 million.

It has been my experience that students who work while attending school do so because they need the money to help pay for education. Because of the reductions in the availability of grant funds in recent years and higher costs, students have increasingly been forced to use loans as a means to finance their education. Many prefer to work in order to minimize the size of the educational mortgage they must face at graduation.

The trend toward larger student indebtedness has become a matter of national concern. Adoption of the administration's Social Security request would compound the problem. The Joint Economic Committee published a report recently on student debt which describes the issue fully.

I fear that enactment of this proposal would either force further tuition increases or reduce the availability of part-time employment for students or more likely a combination of the two. I do not believe it is necessary to describe at length that the University of Michigan does not have a total of \$5.2 million available to make a permanent increase in its budget to accommodate a change of this magnitude.

Acceptance of this proposal would create a major problem for the university and higher education in general while making a minor contribution to the Social Security Program. I believe that students generally will make up for any foregone contributions as students through higher contributions during the course of their careers.

I understand the arguments and am sympathetic toward universal coverage for Social Security. However, I believe that the benefits of current law to students far outweigh those that the extension of coverage might bring them. In any event, I would recommend that the Committee conduct a complete study of the issue if it wishes to seriously consider the administration's proposal.

Mr. Chairman, I urge you to reject this proposal.

I would be happy to answer any questions you might have.

[The prepared statement follows:]

STATEMENT OF THE

AMERICAN COUNCIL ON EDUCATION

ON BEHALF OF:

Association of American Community and Junior Colleges
 Association of American State Colleges and Universities
 Association of American Universities
 Association of Catholic Colleges and Universities
 Association of Jesuit Colleges and Universities
 Association of Urban Universities
 Council of Independent Colleges
 National Association for Equal Opportunity in Higher Education
 National Association of College and University Business Officers
 National Association of Independent Colleges and Universities
 National Association of State Universities and Land-Grant Colleges
 National Association of Schools and Colleges of the United Methodist Church
 National Association of Student Financial Aid Administrators

Mr. Chairman and Members of the Subcommittee, we wish to submit the following statement for the hearing record:

The Administration's FY 1988 Budget proposes to repeal the 48-year-old law providing that the Social Security (FICA) tax is not to be levied upon wages earned by students from jobs provided by the college or university they attend. Far from ending any statutory anomaly, or closing an unjustified gap in program coverage, the proposal overturns an important and longstanding policy. The revenues that would be added to the Social Security Trust Fund are relatively insignificant, but the amounts in question would impose major financial burdens on needy students and college aid programs, which seem not to have been anticipated or considered by the Administration.

Background

Since 1939, Section 3121(b)(10) of the Code has provided that the FICA tax shall not apply to a student's earnings from a job provided by his or her school, college or university.¹ This policy has been based on the understanding that such student jobs are quite unlike the arms-length relationships that characterize most employment in the economy. Rather, most school-provided student jobs are means by which a college or university furnishes financial aid or designs its fellowship and work-study packages. Few student jobs pay wages much exceeding the minimum wage. The great majority are part-time (10-20 hours per week) and last only during the academic year. Most are awarded on considerations taking into account student financial need and/or merit.

Students and schools unquestionably enjoy some benefit from the fact that these jobs are not subject to the same FICA tax as virtually all other jobs. But the law has always considered that, for nonprofit educational institutions and needy students, this short-term benefit is by no means an unfair advantage. To impose a tax of nearly 15 percent on these jobs would seriously burden needy students and reduce financial aid and fellowship and scholarship programs throughout the nation. Most students who hold these jobs work because they cannot otherwise afford to pay for their education. A reduction of at least 7 to 15 percent in their income will be a heavy blow. Similarly, the Administration proposal would have the effect of slashing college and university operating funds as well as financial aid resources by big amounts. To implement this proposal together with the Administration's recommendations to curtail federal financial aid to students would necessarily deny educational opportunity to hundreds of thousands of students.

¹Section 3121(b)(10) of the Code defines "employment," for the purpose of the FICA tax, not to include "service performed in the employ of . . . a school, college or university . . . if such service is performed by a student who is enrolled and regularly attending classes at such school, college or university."

Discussion

The Administration's proposal ignores the considerations underlying the FICA policy of nearly a half century's duration.

The Administration argues that the original purpose of the existing exemption to protect schools from the administrative burdens of withholding and paying taxes on the wages is obsolete due to the automation of institutional records. But for many schools -- particularly smaller institutions -- the removal of the exemption would impose real and substantial burdens. More important, however, would be the impact on college operating funds, financial aid, scholarship and work-study programs. For example, the University of California alone calculates that, under the Administration proposal, it would have to pay \$12.8 million in employer contributions during FY 1987 and its students would have to pay the same amount in employee contributions. From that one institution, in other words, more than \$25 million would be diverted from student financial assistance. The University of Michigan and its students would lose more than \$6 million.

The Administration also asserts that its proposal would provide important protection for a segment of the public -- students -- not now covered by Social Security. But most students remain dependents of their parents and do not earn enough from their part-time student jobs to qualify for coverage. A smaller, not greater, proportion of today's students than those in the past are married with children; in most of these cases, the student has a working spouse or holds a full-time job and attends school part-time. Almost all students are fully covered by university healthcare programs and have no need for medicare (assuming the dubious proposition they could qualify). We are aware of no study concluding that students could achieve any genuine benefits from paying Social Security tax on their part-time school-provided jobs. The Administration does not suggest that it has ever studied the question and we are certain that the conclusions of such a study would not support the Administration's proposal.

Conclusion

By contrast with the major effect the Administration proposal would have on students and institutions of higher education, its revenue contribution to the Trust Fund would be trivial in relative terms and cannot be justified on the grounds of current or projected revenue need.

Nor should part-time student jobs be placed in the same category as various loopholes in program coverage that have been the subject of attention in recent years. Student jobs are temporary, of several years' duration at most, after which the student joins the labor force and can be expected to make his or her fair share of contributions over an entire working lifetime. Higher education no doubt increases Social Security revenues by increasing the wage base on which graduates are taxed. Student jobs do not present the situation in which a whole segment of the economy participates in an alternative to the Social Security system that undermines the objective of universal coverage. It is merely a short delay in participation that serves to increase the participant's capacity to contribute in the long run.

In the final analysis, the Administration proposal is unnecessary from the standpoint of program revenue needs. It ignores that part-time student jobs are more in the nature of financial aid/work study benefits than regular employment compensation. And the effects of the proposal are potentially devastating. It would curtail substantially the resources available for financial aid. Many students may lose the chance for an education. Others might scrape by through heavier borrowing, adding to the student debt-burden problem that justifiably is causing increasing alarm throughout the country. The students themselves will derive no real tangible benefit from the proposal. And we believe that, by reducing the numbers of students who can afford to obtain degrees, the proposal would ultimately reduce the amount of contributions to the Trust Fund.

We urge the Subcommittee to reject this proposal.

Chairman JACOBS. Thank you, sir.
Bob?

**STATEMENT OF ROBERT J. MYERS, SILVER SPRING, MD., FORMER
CHIEF ACTUARY OF THE SOCIAL SECURITY ADMINISTRATION**

Mr. MYERS. Thank you, Mr. Chairman.

I think it is fair to say that over the years, there has been widespread agreement that extension of coverage for the Social Security program should be to as wide a base as is feasible.

In view of this, I endorse all of the changes in the President's budget for these relatively minor extensions of coverage.

What I want to do now is draw the attention of the subcommittee to one coverage area where there is widespread and growing abuse to the effect that both less taxes are collected and also more benefits are paid. This particular area is in regard to directors' fees.

Under existing practices, directors of corporations are considered as self-employed persons. The law itself is not specific on this, but rather regulations issued years ago said that directors would be considered as self-employed.

Here is what happens: Suppose there is a director of a corporation who is age 65 and is getting directors fees of \$25,000 a year, and that is all the employment that this person has. What is very widely done—and this is growing—is that the director says, "Give me \$8,000 in cash and defer the other \$17,000 until after I am 70 years old."

Since self-employment income for purposes of the retirement earnings test counts when paid and not when earned—as do wages—this individual, then, receives full Social Security benefits each year because, having only \$8,000, he or she is under the maximum allowable under the earnings test for receipt of full benefits. Then when reaching age 70 a lump sum payment of about \$100,000 would be available, only part of which is taxable. If the fees were taxed at the time earned, it would mean more taxes for the system; also the person would not get benefits before age 70.

It only seems fair that persons earning that type of money in director's fees should not be able to get retirement benefits, when the average worker who earns, say, \$25,000 is subject to the earnings test and may well lose all of the benefits before age 70.

The cure to this problem is relatively simple: By definition, legislate that directors of corporations will be considered for Social Security purposes to be employees.

As the subcommittee well knows, this empirical classification between employees and self-employed is done in a number of other categories—for instance, full-time life insurance salesmen, even though they may be self-employed, are classified as employees.

Other people who are actually employees sometimes are classified as self-employed. So it is, I think, perfectly feasible and legal to do what I suggest as to director's fees.

One other thing that I would want to draw to the attention of the subcommittee that may not quite be within the scope of this hearing, but if technical amendments are made, it may be of interest—is in the retirement test area.

As you know, there is a different annual exempt amount for people over 65 and people under 65—this year \$8,160 annually for persons over 65 and \$6,000 for those under 65.

There is an anomaly that results. Suppose somebody is going to become 65 this year. At the beginning of the year, they say, "I can earn \$8,160, and still receive full benefits," and they proceed to do so. But the anomaly in the law is that if they die before the month they become 65, then the lower amount applies and this person's estate will have to repay the overpayment.

What I suggest is that the division of the earnings test amounts between under and over 65 should apply not to whether the person actually reaches that age, but rather to the age that the person would reach in the particular calendar year to which it is applicable.

Obviously, there would be a little more benefits paid, but it is a relatively small benefit change. However, it would enable people to plan properly so that if they are going to attain age 65 in this year, then at the beginning of the year, they would know how much they can earn, specifically what the law provides.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT BY ROBERT J. MYERS PRESENTED TO THE SUBCOMMITTEE ON SOCIAL SECURITY OF THE COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES, MARCH 5, 1987, WITH REGARD TO SOCIAL SECURITY AND RAILROAD RETIREMENT PROPOSALS CONTAINED IN THE PRESIDENT'S FY 1988 BUDGET

Mr. Chairman and Members of the Subcommittee: My name is Robert J. Myers. I served in various actuarial capacities with the Social Security Administration and its predecessor agencies during 1934-70, being Chief Actuary for the last 23 of those years. In 1981-82, I was Deputy Commissioner of Social Security, and in 1982-83, I was Executive Director of the National Commission on Social Security Reform.

Over the years, there has been general agreement that the coverage of the Social Security program should be extended to as many types of gainful paid employment as possible. In accordance with this goal, I believe that the extensions of coverage proposed in the President's Fiscal Year 1988 budget are desirable, although recognizing that they are relatively minor extensions. I believe that one other change in the coverage provisions should be made because of the significant manipulation of both taxes and the retirement earnings test that is rather widespread in this particular area -- namely, the treatment of earnings of directors of corporations as self-employed persons.

Admittedly, under the common law, such individuals are not employees of the corporations, and accordingly they are classified under the Social Security program as self-employed. The problem which arises is that many such persons who have been highly paid, and were in high-income status over the years, retire at age 65 or shortly thereafter as employees, but continue as substantially paid directors. It is then possible for them to take only a limited amount of their substantial director fees at the time they are serving and to make arrangements to have the remainder paid in the year following attainment of age 70. This can be done without a formal deferred-compensation plan being established. Such practice is widely utilized.

The two-fold result is that (1) despite really earning substantial amounts, they meet the conditions of the retirement earnings test and receive full Social Security benefits each year, and (2) they pay no self-employment taxes on the fees for which payment is deferred until the year after they attain age 70. With regard to the latter matter, the cumulative total of fees paid after age 70 may well exceed the maximum taxable earnings base in that year. Thus, part of the payment may be exempt from Social Security taxation that would not otherwise have been so exempt if paid when actually earned. As you know, the basis for Social Security taxation of earnings for both employees and the self-employed is "when actually paid", whereas for the annual retirement earnings test, the basis is "when earned" for employees, but "when received" for the self-employed.

Let me give an example of a hypothetical, but typical, case. Suppose that, after age 65, an individual has no employment except as a director of a corporation, with annual remuneration of \$25,000. If the person makes an agreement with the corporation to defer payment of all but \$8,000 of this compensation until January 1 following the year of attainment of age 70, full Social Security benefits will be payable each month up to age 70 -- and, of course, thereafter because the earnings test then no longer applies. The individual will pay Social Security taxes on the \$8,000 received each year and then on the retroactive payment received on January 1 following attainment of age 70 (but only to the extent of the maximum taxable earnings base in that year). This result seems very unfair in that relatively high income people can receive full Social Security benefits and at the same time have substantial earned income, whereas other persons who have work only as an employee cannot do so.

My solution to this problem is that directors of corporations should be deemed, for purposes of Social Security, to be employees. There are several precedents for such treatment, such as the deeming of full-time insurance agents to be employees for Social Security purposes even though they are not employees under common-law tests. Then too, there is the reverse procedure for ministers and for American citizen employees of foreign governments and international organizations working in the United States -- namely, classifying them

for Social Security purposes as self-employed persons even if they are really employees.

Certainly, such a procedure would remedy the inequitable situation of such directors receiving full Social Security benefits while earning sizable amounts. It is true that for purposes of both income taxes and Social Security taxes the individuals involved could enter into regular deferred-compensation agreements, but nonetheless, Social Security taxes would be payable at the time the services are rendered if there were no substantial risk of forfeiture of such amounts in the future (as would be the basis which the individuals involved would undoubtedly expect).

Although this hearing is concerned only with coverage insofar as the Social Security program is concerned, I would like to mention one small, but serious anomaly now existing with regard to the retirement earnings test. Hopefully, when this subcommittee considers technical amendments and corrections at some later time, it may wish to take action on this matter.

As you know, the annual exempt amount under the earnings test is higher for persons at and above the Normal Retirement Age (now 65) and up to age 70 than it is for younger persons. For example, this year, the two figures are \$8,160 and \$6,000. An anomaly occurs for the year in which persons attain the Normal Retirement Age if they die in that year. Such persons who live at least through the month before the Normal Retirement Age have the higher amount as the test. But if they die in a previous month, the lower test amount applies.

Consider an individual who is working at the beginning of the year and earns up to the exempt amount applicable to those who live at least to the month of attaining the Normal Retirement Age. Such person may find -- or rather, the survivors will find -- that there have been "excess earnings" if death occurs before the month of attainment, as against what would happen for death at a later time.

I believe that a change should be made so that the higher annual exempt amount applicable for those who actually attain the Normal Retirement Age in the year of death should also be applicable to deaths in that year before such attainment. This would provide equitable and consistent treatment, so that the people involved would, at the beginning of the year, know exactly where they would stand with regard to the amount of permissible earnings. The cost effect of such a change would be relatively negligible, but such a change would remedy a serious inequity for some people.

Chairman JACOBS. Thank you.
Mr. Grisanti?

STATEMENT OF MICHAEL J. GRISANTI, VICE PRESIDENT, NATIONAL RESTAURANT ASSOCIATION, AND VICE PRESIDENT AND CHIEF EXECUTIVE OFFICER, GRISANTI, INC., LOUISVILLE, KY.

Mr. GRISANTI. Thank you, Mr. Chairman. I appreciate your giving the National Restaurant Association an opportunity to testify before the Social Security Subcommittee of the House Ways and Means Committee. If you have no objection, I would request that our testimony be made part of the record.

The National Restaurant Association is the leading trade association for the food-service industry, which comprises 593,000 units in the United States and employs over 8 million people.

I am Michael Grisanti, a restaurateur from Louisville, KY, and I operate eight restaurants in five States: Kentucky, Indiana, Nebraska, Colorado, and New York.

Mr. Chairman, during the President's weekly radio address on January 3, he declared that the budget he was about to submit to Congress for fiscal year 1988 was a "no-tax increase budget." Contrary to what the President has said, however, there are tax increases in the administration's budget. I am here today to talk about one of these.

The administration's budget contains a provision designed to raise \$200 million in the first year and \$1.6 billion over 5 years—all at the expense of the restaurant industry.

To accomplish this, the administration has proposed that the employers pay Social Security or FICA taxes on gratuities that waitresses and waiters receive from restaurant customers.

We object to this proposal for three reasons:

First, the president's proposal treats tips received by employees as if they were wages paid by employers. The FICA tax is a payroll tax and tips are not part of the payroll. Tips given to a server by a restaurant guest, a transaction over which the employer has no control, simply are not wages. To hold an employer responsible for paying FICA, a payroll tax, on nonpayroll income would be a significant change in tax policy.

This same proposal was raised once before during debates on Social Security amendments in 1965. At that time, Congress rejected the proposal, concluding: "Tips are not considered as remuneration for employment for purposes of the employer taxes imposed under Section 3111 of the Code." We see no rationale or new information to justify reversing this conclusion in 1987.

Second, Mr. Chairman, this tax increase is unsound public policy. Traditionally, Social Security taxes have been raised for two reasons: because the Social Security trust fund is in financial trouble and needs help, or because the Government wants to provide more benefits to Social Security recipients. In this case, the tax increase is not needed for either reason. Clearly, the trust fund is solvent. Moreover, this proposal would not benefit the tipped employee. Tipped employees already pay FICA taxes on their tips and are entitled to collect full benefits on their total income at retirement.

So why has the administration called for it? Because the \$200 million raised by the proposal can be used as a bottom-line offset against the fiscal year 1988 Federal deficit. However, the revenue has no real effect on the Federal deficit. The \$200 million could only go into the Social Security trust fund. The revenue could not offset any cuts which the administration's budget proposes for other Federal programs, since the \$200 million could not be spent for any other Federal program.

This tax increase boils down to an accounting sleight-of-hand that purports to bring down the Federal debt, but only hurts the restaurant industry.

Third, Mr. Chairman, we oppose this tax increase because it would have the greatest impact on the operators least able to absorb it—the small business person.

Nearly 93 percent of the food-service establishments that employ tipped workers have annual sales volumes below \$1 million. This sales volume hardly constitutes a major operation. Yet, it is in this segment of the food-service industry that our tipped employees are concentrated, and it is this segment which would be most affected by the administration's proposal.

The National Restaurant Association's research department has put together an illustration of how a table service restaurant with annual sales of \$1 million might be affected by the administration's proposal. In this restaurant tipped employees average \$3.70 per hour in tips and earn cash wages of \$2.01 per hour.

Currently, the employer is liable for paying FICA taxes on \$3.35, the minimum wage. This translates into employer FICA payments——

Chairman JACOBS. Mr. Grisanti, your time has expired. Perhaps you can develop points during the questioning period.

[The portion of the prepared statement not read, follows:]

CONTINUATION OF STATEMENT OF MICHAEL GRISANTI

Currently, the employer is liable for paying FICA taxes on \$3.35, the minimum wage. This translates into employer FICA payments of \$0.24 per hour for each tipped employee.

Under the administration's proposal, the employer FICA contribution would shoot up to \$0.41 per hour for each tipped employee. In this fictional restaurant, which represents neither the best nor the worst case scenario, employer FICA payroll costs would increase 71 percent.

Increasing payroll costs in this way would impose a significant burden on these small operators. A study conducted last year showed that this type of restaurant reports pre-tax net income of 4.9 percent. If the administration's proposal took effect, this pre-tax net income would decline by 9 percent.

To burden these small operators seems unjustified and unwise. The failure rate for tableservice restaurants is already high: Over half of all new restaurant operations fail within their first 2 years.

The folly of this proposal should be clear to even a casual student of government. Plainly, this proposition is solely revenue-driven.

But to raise revenue through increased Social Security taxes that can only go into an already-solvent trust fund is unfair. Thousands of restaurateurs would be hurt if this proposal were enacted.

Finally, Mr. Chairman, let me briefly explain the financial impact of the proposal on Grisanti, Inc. Each of our restaurants employs approximately 130 people; about half of these are tipped employees. According to my company's projections, if the FICA on tips provision becomes law, it would cost each one of our restaurants an additional \$11,000 per year in employer-paid FICA taxes. Although the President may not consider this a tax increase. I can assure you that those of us in the restaurant industry can view it no other way.

In summary, FICA on tips is a tax increase which (1) hurts employers, most of whom are small business people; (2) is of no benefit to the employee; and, (3) does not reduce the deficit.

Thank you, Mr. Chairman and members of the committee, for this opportunity to appear. I thank you for listening to those of us who live and work outside of the Capitol Beltway in order to learn the impact of the policy decisions that you face.

I look forward to answering any questions.

Chairman JACOBS. Mr. Daub.

Mr. DAUB. We are glad to have your restaurants in Omaha, Nebr.

Mr. GRISANTI. Thank you. We are thrilled to be there.

Mr. DAUB. Yes. I figured that might be one of the reasons why you are here today.

We welcome all of you. I guess the thing we have to struggle with is the idea that it is important for a part A or a part B benefit, that if you are going to be entitled to it, you ought to have to help pay for it. I think that is very important. That is a matter of policy that we need to be very careful to understand here.

It is technical, it is complex, and whenever you start looking at broadening the net you sincerely are interested in being sure that the element of fairness applies to those who are already in. When you have them bring to your attention that there are some people getting a benefit and it does not appear like they are paying all their own way, you have an argument.

It is the farmer who has done well enough to be able to borrow his money at 12 percent, and the farmer who has not done well enough; he can get it from the Government at 7. And they are both putting hogs on the market. Because one guy can get the money cheaper from the Government, he can make more money than the guy who is on his own. So it is a tough struggle for this committee.

Social Security is not a subject any of us like to talk about when it comes to adding people to the system, when they have to pay. But they are mighty glad they were there and the system is solvent when they get to the other end and they want to use it.

Do you think that that withholding that you just talked about, in the attempt to finish your statement, is really unfair to the extent that there is no subsidy now being carried by other people for that employee when we look at that tip as income?

Do you think they are paying their full way or you are paying your proportionate part of their full way in the system?

Mr. GRISANTI. I think that from our standpoint, as was decided in 1965, the tip income really is looked at as other income for many reference points, and it is difficult for us, as employers, to pay taxes—or FICA taxes, in this particular case—on tips or income that we have no control over.

We clearly feel it is our responsibility to pay our share on wages that we have control over. But when there is a third party transaction taking place, it is difficult for us to feel as though we should be in a position to participate in that transaction.

And that, basically, is our position.

Mr. DAUB. Morris West wrote the book "The Devil's Advocate." Part of our job is not necessarily to indicate how we feel on the issue but try to get from you information so we can evaluate it better. I appreciate that answer.

I want to shift to the college environment where, quite honestly, one might argue there is a better case. But students could be covered under disability; right? I mean, they could get hurt.

They could have as little as six quarters of credit up to that point when they get into college from other previous part-time work and all of a sudden get hurt, and the system is going to have to lay out a whole bunch of money.

Mr. BUTTS. That is correct, Mr. Daub. The question is a matter of balance in terms of the benefits each way.

I would point out that at the University of Michigan, all of our student employees are covered by workmen's compensation, which accommodates disability, medical, and an indemnity.

Mr. DAUB. Your football players are covered by workmen's comp?

Mr. BUTTS. Well, I do not know. But the basketball game with Purdue this Saturday night—

Mr. DAUB. Then you might argue they are employees of the State, then. There is a Senator from Nebraska who argued that we ought to make every football player an employee of the government.

Mr. BUTTS. We have heard that argument. We respectfully believe that they are gaining something from their experience.

I believe the extension of the disability benefit to younger workers is something that needs to be analyzed. But in the process of that analysis, we need to look at the extent to which programs such as State workers' compensation programs might be already accommodating the students. Some 16,000 of our 19,000 students, roughly, are earning an average of about \$1,000 a year.

When students are employed during periods of nonenrollment—when they are not regularly attending classes, such as in the summer—they are covered by Social Security withholding.

Students, while on campus, are exempt, but typically they have multiple jobs, and I suspect are accumulating credits toward disability. We need further study just to see what the relative trade-offs are between extending that benefit and what—really tremendous cost—would be to institutions to try to make up the difference.

Mr. DAUB. Well, I have concluded, Mr. Chairman. I want to thank the panel very much for coming, and I appreciate the answers to the two questions I posed to each of you.

I do think, Mr. Chairman, we ought to correct the record. I notice on the list of witnesses that Mr. Fontaine is from Pascagoula, Miss.

Thank you, Mr. Chairman.

Mr. ARCHER. Thank you, Mr. Chairman. I would like to just continue to piggyback a little bit on what my colleague, Hal Daub, was getting at.

Our difficulty is, as I see it, not to balance a budget or to locate new sources of revenue, and I think your comments, Mr. Grisanti, are very, very good. This is a new tax; any way you look at it, it is a new tax. It is additional revenue coming in.

That should not be the purpose of this committee. Our purpose should be to create equity in the Social Security system and to be sure that we have a viable fund that will meet the requirements

not just in the next 10 years or 15 years but in the next 75 years. That is what we are charged with; that is our responsibility.

We just had, prior to your testimony, a group of people who were here to testify on the railroad retirement fund, and I asked them why they were in such trouble today and why their payroll taxes were so high today.

It is clear that the reason was that at one point in time when they had more employees, they built up enough money in the fund to where people could come in and say, "Well, let's increase the benefits and let's do this and let's do that," without regard to what was going to happen farther down the line.

The fact that the fund is solvent now should not be the determining factor in what we do because we are charged with the 75-year responsibility. I only say that to you because I think you need to understand what our problems are as we need to understand what your problems are.

There is no question but what all of you validly state positions that I would take if I were in your position, sitting on the other side of the table. But I would like for you to get in our shoes, too, and understand the difficulties that we face.

I was a small businessman myself before I came to Congress, and I know the difficulties of having to bear the burden of the payroll taxes, and you do not want to have to bear any more.

But we have got to find a way out of this dilemma that we are in to find a consistency for the program, equity for the program, and also to be sure that those people who are going to get benefits have paid their fair share into the program. And that means students, that means restaurant workers, and everybody across the board.

Now I might say that if we had greater savings incentives so that people provided for their own retirement, et cetera, it would be a different situation. But we have got to basically shore up the fund and see that we have a viable Social Security program.

Now, Mr. Grisanti, let me just ask you this: You say you have no control over these wages for your employees. And I understand your position on that. But you do have—you are required under the law to have control up to the minimum wage.

The amount of actual payroll that the average restaurant pays to its employees is less than the minimum wage. And based on your testimony it is because of the inclusion of a part of the tips that you get up to the minimum wage.

So to that degree, you have some control. And you are already paying Social Security taxes on part of the tips that that employee earns; is that not correct?

Mr. GRISANTI. That is correct.

Mr. FONTAINE. No.

Mr. GRISANTI. To the degree—up to the minimum wage, you are correct.

Mr. ARCHER. Mr. Fontaine, do you disagree with Mr. Grisanti?

Mr. FONTAINE. No, I agree with him, that we are not paying Social Security now. Only the employee is paying Social Security on the tips that are withheld.

Mr. ARCHER. We need to get both of you together on that, because you disagree. It is my understanding that—

Mr. GRISANTI. I do not think we do disagree. I think the point that Doug is making is that we pay Social Security tax on that amount of tip income that brings the employee to minimum wage.

Mr. ARCHER. Right. That was my question. Right.

Mr. GRISANTI. We do not currently pay beyond that point, even though they may report more than that.

Mr. ARCHER. OK. So your answer is the accurate one. Now to the extent that tips exceed the minimum wage, then you are not obligated. But you do have to keep all the records today, do you not, in order to submit what is considered to be a reasonable report of tip income to the Social Security Administration for the purpose of setting up the earnings record for that employee.

Mr. GRISANTI. We do keep records, but those records are really based on the information that is given to us by employees.

Mr. ARCHER. I understand.

Mr. GRISANTI. That is a very important point to make. To say that those records are as accurate as our own records on funds that we control would be a misstatement.

Mr. ARCHER. OK. But you do have to accept, under the law, the accuracy of that to the extent that it is required to meet the minimum wage.

Mr. GRISANTI. I cannot really argue with that. Because we are doing that now does not diminish our argument against paying taxes on wages we do not control.

Mr. ARCHER. I understand. But what we find ourselves in is in a gray area. The employee is getting in his earnings record, or her earnings record, as the case may be, a Social Security benefit that is building up over the years, based on what he submits to you as what his tips are in total, and in addition to whatever you pay them as an hourly rate.

And yet only half of the amount of money is being paid into the fund that other people have to pay in to get that same earnings record. How do we cope with this? How do we create equity in the fund, and how do we see that the fund builds up over a period of time so that we do not have to tax future workers after the year 2000 to make up for the deficit, and find ourselves in the railroad retirement type of situation?

Mr. GRISANTI. I think that there is something to be understood, and that is that this tip income is like no other income in this country, and unlike any incomes in other countries. In Europe they have service charges. I think to make it clean and simple we really ought to be having service charges in this industry. But we do not. We have tip income. The reality is we do not control those dollars. What you are proposing, if I look—

Mr. ARCHER. I am not proposing anything. I am trying to inquire and find out what the appropriate position for me is, in this issue.

Mr. GRISANTI. I think if you look down the road at the potential contingent liability of an operator such as myself—I have no control over those incomes paid in tips. Yet this proposal would have me pay FICA taxes, and be liable for those taxes.

Suppose I have an operation where a number of people are reporting inaccurately. Suppose later they are found to be reporting inaccurately. Does that mean 5 years down the road I have got a

liability to pay those taxes? That creates an environment that is just impossible for a small businessman to operate in.

Mr. ARCHER. I fully understand that, but I hope you understand our problem, too. What I am asking you for is some suggestions as to how we get to a place to where we do not violate your situation, but we also have an equitable program as far as Social Security is concerned. We need some constructive input from you. In other words, we want to understand your problem, but we want you to understand ours, too.

Mr. GRISANTI. I wish I could offer you a solution.

Mr. ARCHER. I have exceeded my time, and I thank you, Mr. Chairman.

Chairman JACOBS. That is all right. Mr. Levin.

Mr. LEVIN. Just to follow up—where an establishment pays the minimum wage and it adds 15 percent for tips for the employees, is FICA paid by the employer?

Mr. GRISANTI. That is a service charge, and yes, it is. You change the categorization. If I am charging—

Mr. LEVIN. Even if it is a tip. Even though it goes to the employee.

Mr. GRISANTI. If I as the establishment require the guest to pay that fee, it is a service charge by classification, and yes, FICA taxes are paid on that. And that is not, again, the point that we are arguing.

Mr. LEVIN. The point that you make about liability—that could be handled, could it not, by a provision allowing the employer to reasonably rely on the information given to the employer by the employee? That is really what is done with minimum wages, right? The employer relies on the employee's information.

Mr. GRISANTI. I am not sure that I—

Mr. LEVIN. One of your arguments against change is, what happens 5 years from now if the employer relied on information from an employee and it turned out the employee was incorrectly indicating the information.

That could be handled by protecting the employer where they reasonably relied on the information supplied by the employee as to the amount of tips.

Mr. GRISANTI. I do not know the code well enough to know if that would be palatable, but that really does not, I think, get at the original argument.

Mr. LEVIN. Which is?

You raised the argument about reasonable reliance. So what is the argument, if you are allowed to rely reasonably on the information given to you by the employee? Why not require the employer to pay the tax?

Mr. GRISANTI. If you go back to the code, we are talking about payroll taxes—payroll, a tax on payroll—and tip income is not payroll.

Mr. LEVIN. Except, as Mr. Archer pointed out, already in the example you give on page 4, part of the tip is already, in effect, included within the FICA because the wage is usually below the minimum wage, so part of what is being paid on is really tip income. That is your own example.

Mr. GRISANTI. That is true. I am not suggesting that I agree with that.

Mr. LEVIN. But that wall has already been breached. And so the question is, as long as you can reasonably rely on the employee information, in terms of any criminal activity or even later in payments—

Mr. GRISANTI. I think that goes back to an agreed-upon wage. That is a relationship that an employer has with an employee. We have agreed upon a wage. We have agreed to pay them \$2.01. They have agreed to claim tips to meet the \$3.35 an hour. As an agreed-upon wage, it falls under payroll classification.

Mr. LEVIN. I guess we have to go. The 10-minute buzzer has also rung.

Mr. Butts, let me just indicate—on page 2 you say, at the end, “however, I believe that the benefits of the current law to students far outweigh those that the extension of coverage to them might bring.”

I think you are going to need to assure the committee that that is a standard that we can utilize. We do not utilize that standard in the application of Social Security taxes. We do not look at every industry and say, do the benefits to the employee not outweigh the extension of coverage?

So I think we are going to need to know whether that is an adequate measuring rod to apply.

Mr. BUTTS. The cost of it to the individual who may be disabled and receive the benefit is extremely important. As I pointed out, you understand that in a complete analysis of the issue that should be taken into account. For students working their way through school, 7.15 percent reduction in wages and reduction in the effectiveness of appropriations for the college study program.

Mr. LEVIN. We do not ask whether it will help or hurt the employee more to pay the 7.15 percent.

So the real issue is, why should we do it here?

Thank you. I guess we have to go.

Chairman JACOBS. A quick question for Bob. What was that figure on military payroll?

Mr. MYERS. The figure for the military retirement system, including not just new entrants but everybody in it, is about 55 percent of the total payroll on which military retired pay is based—that is, exclusive of quarters and subsistence allowances—the figure based on total payroll including quarters and subsistence allowances is 41 percent—to which should be added about 10 percent, representing the employer-employee cost of the Social Security cash benefits program. And for civil service retirement, it is about 42 percent.

Chairman JACOBS. And Bob, how are Members of Congress deemed, with reference to your observation on directors of corporations, how are Members of Congress deemed—what status have Members of Congress under the Social Security system. Are they not deemed to be employees?

Mr. MYERS. They are all deemed employees.

Mr. ARCHER. Mr. Chairman, just one last quick question, for Mr. Butts.

Do you know offhand what percent of your working students have children?

Mr. BUTTS. Offhand, I do not.

Mr. ARCHER. Because to the extent that any of them do have children, you have an additional benefit that is worth an enormous amount to them. In the event of their untimely death, their survivor is going to get a rather large amount of monthly benefits until reaching age 18. And that has to be factored in, too.

Mr. BUTTS. I understand that.

Chairman JACOBS. Let me just make one observation, Mr. Butts. As I understand your theory, somebody starting out in life does not get on the Social Security contribution train until he or she is into the work force, even though the earlier contributions might do something to enhance the retirement years of that same individual.

Is that correct?

If you guys could do a little more about encouraging your students not to start smoking, or keep smoking, when they are in college, so that the other end, in the retirement years, they will not have a worse retirement, for obvious reasons, I think you will have a stronger argument.

Mr. BUTTS. Thank you, sir.

Chairman JACOBS. These hearings are concluded, and we express our gratitude to this panel.

[Whereupon, at 11:15 a.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF
FORMER CONGRESSMAN JAMES ROOSEVELT
CHAIRMAN OF THE
NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

I am James Roosevelt, Chairman of the National Committee to Preserve Social Security and Medicare. On the important issues of Social Security and Medicare, I now speak for more than four million members, most of whom are already retired or close to retirement age. Recommendations made by the Social Security Administration to modify the Social Security program in any way are of vital importance to our members. I am, therefore, very pleased to comment on the Fiscal Year 1988 budget proposals for Social Security and Railroad Retirement.

New Social Security Coverage

The enhancement of trust fund reserves, as forecast in the budget through expanded coverage and the requirement for full employer contributions, should, in our view, be recognized as a byproduct rather than the objective of broadened Social Security coverage and sound financing policy. The National Committee strongly supports universal coverage as a means of assuring the full and valuable protection of Social Security to all workers and their families. For this reason, we endorse the proposals in the budget to bring additional workers under Social Security and to require matching employer/employee contributions in all cases.

In like manner, we urge the expansion of Social Security protection to one additional group. The Social Security Act enables State and local units of government, who voluntarily participate in Social Security, to exclude part-time employees. As a result, many part-time public employees have no retirement income protection whatsoever. We recommend that State and local units of government, who have elected to come under Social Security, be required to cover under Social Security all employees who earn \$50 or more in a calendar quarter.

Railroad Retirement Contribution Increases

The National Committee offers no recommendation with regard to the budget's proposed increase in contributions to the private pension component of Railroad Retirement. Before any additional contributions are imposed, however, we would urge that Congress extend vesting guarantees and prohibitions against excessive integration with the Social Security equivalent as have been granted to all other workers in our economy.

The Railroad Retirement Act's "overall minimum" guarantee that railroad annuitants will always receive a benefit equal to that which would have been paid under the Social Security Act does not apply to divorced spouses or to a great many other categories of workers, former workers or their dependents. Additionally, whenever benefits are paid under the overall minimum, the private pension component earned by the worker, which otherwise would have been paid, has been totally integrated with the Social Security component, a practice which Congress has prohibited in every other qualified pension plan in this nation.

Empty Agenda

While we are pleased with recommendations to broaden coverage, we call to the Subcommittee's attention that nowhere in the budget does the Social Security Administration recommend changes which would improve adequacy or equity, however nominal the cost. In our view, the Social Security Administration has a dual responsibility. It is obligated to properly administer the program as it exists in current law and assure that all appropriate benefits are paid. A second, equally valid obligation is to apprise the Congress of areas where reform or modification is warranted to meet the changing needs of our society.

For example, the Administration ignores the many legislative recommendations to incrementally improve benefits for women as wage earners or as survivors of wage earners. The 1985 Report on Earnings Sharing Implementation Study analyzed and provided cost estimates for a number of very modest proposals including benefits for disabled widows or delayed retirement credits for widows who stay in the work force past retirement age. The enactment of such changes would not threaten the integrity of the Social Security Trust Funds. Yet this Congress has received no recommendation to consider these proposals.

Similarly, although the Social Security Administration's budget recognizes that the Railroad Retirement Act does not always provide Social Security equivalent benefits to railroad workers and their families, no recommendation is made that these benefits be mandated.

Deficit Impact

Emphasis on the "bottom line" to the exclusion of all other considerations dominates this Administration's budget proposals on Social Security and Railroad Retirement. The pursuit of productivity, new tax revenues, and even protection of Trust Funds Reserves are not goals in and of themselves, but a means to preserve and protect the Social Security program. We object strenuously to including new Social Security revenues as part of "deficit reductions." Social Security revenues are part of Social Security financing, not government financing of the deficit.

Conclusion

Yesterday's workers, today's and tomorrow's recognize their own self interest in the preservation of Social Security. "Preservation" is not limited to opposition to proposals to cut benefits, it also means assuring that all workers receive a benefit that is adequate and equitable. This is preservation in the real sense and it is in that sense that my organization has recommended benefit equity reforms in its Legislative Plan for the 100th Congress in the area of disability reform and a more gradual phasing in of the new benefits formula to ameliorate "Notch" benefit cuts in its Legislative Plan for the 100th Congress. I urge the Subcommittee to consider our legislative goals in the area of Social Security and go beyond the limited proposals in the Administration's budget.

I have attached excerpts from our legislative objectives for your consideration.

Thank you Mr. Chairman.

RECOMMENDATIONS CONCERNING SOCIAL SECURITY EXCERPTED FROM
THE LEGISLATIVE PLAN FOR THE 100TH CONGRESS
PREPARED BY
THE NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

Financing

The National Committee views Social Security as a self-financed social insurance program. Retired workers and their families receive benefits based on contributions to Social Security made during their working lives. Therefore deficits in other government programs should not threaten these benefits. By the same token, Social Security trust fund reserves which are accumulated to provide for future contingencies should not be used to cover up government deficits. Using trust fund reserve figures to meet deficit reduction targets, as is done currently, effectively precludes any improvements in current benefits, no matter how justified.

A soundly financed Social Security program assures all Americans that they will receive the benefits promised them. The current financing arrangement does not provide a guaranteed, permanent financing structure. Even though the trust funds are projected to amass large reserves over the next 30 years, those reserves will then be quickly drawn down, reaching a negative balance in mid-century. The National Committee recommends as better policy, the maintaining of the contingency trust funds at a level equivalent to 100 percent of a full year's benefit payments -- either by an automatic floating payroll tax rate or by a change in the payroll tax rate schedule. This National Committee proposal is not only consistent with the traditional "pay-as-you-go" financing philosophy of the Social Security system, but it also will lessen the Social Security tax burden on current workers without unduly increasing the payroll tax burden on future generations.

Safeguarding the integrity of the Social Security Trust Funds is vital to assuring that those dollars are used strictly for Social Security purposes. The National Committee strongly urges enactment of safeguards to prevent the unauthorized disinvestment of Trust Funds and to guarantee benefit payments. Safeguards should not be so strict as to jeopardize benefits.

Correct Notch Benefit Inequity

The National Committee is very concerned that budget considerations have too long prevented the Congress from reviewing and correcting obvious benefit inequities in current law. A major example of benefit inequity is the disparity in payments to persons born in 1917 and afterwards in comparison with those born in the preceding five years. Although the Social Security Amendments of 1977 intentionally reduced future benefits, the precipitous drop in initial payments, resulting partially from economic conditions which differed from those forecast, was certainly not intended. While the cost of correcting the Notch could be significant, the National Committee believes Congress has an obligation to reopen this issue and restore to Notch beneficiaries a fair and adequate payment.

Remove Disability Inequities

The stricter disability standards applied to widows or widowers is a severe inequity. Disabled widow(er)s must be at least fifty years of age, must qualify within seven years of the

death of a spouse, and must meet a more stringent definition of disability than applies to any other applicant for Social Security Disability Insurance benefits, Adult Disabled Child's benefits or Supplemental Security Income. The National Committee recommends repeal of harsher disability criteria applicable only to widow(er)s.

The National Committee also recommends paying benefits to the spouse of a beneficiary when that spouse is disabled or is caring for a disabled beneficiary even if that spouse has not yet reached retirement age. One final recommendation regarding disability insurance protection would modify the "recency of work" rule to disregard years spent caring for children under age seven, older disabled children, or adult family members in need of attendant care.

Encourage Older Workers

Society today fails to take full advantage of the skills and productivity of seniors only because Social Security imposes financial disincentives to continue working. Studies conducted by the Social Security Administration confirm a majority of those individuals who remain in the work force on a part time basis or who reenter the work force after receiving benefits do so because they require additional income to supplement Social Security benefits. Yet these workers face a loss of benefits if they earn more than the minimal amount referred to as a "retirement test." Social Security does increase benefits through a "delayed retirement credit" to those who lose benefits due to working, but the increase does not make up for benefits lost by delaying retirement.

The National Committee urges Congress to rethink the current policy that benefits belong only to those substantially retired, and to eliminate the retirement test as inconsistent with sound employment policy.

The work disincentives in the Social Security Act are in direct contradiction to other government programs designed to promote the employment of older workers. The National Committee urges Congress to both remove Social Security work disincentives and strengthen employment programs under the Older Americans Act.

As a first step, incentives to work could be increased now by both liberalizing the retirement test and improving the delayed retirement credit as already envisioned in current law for implementation in 1990. As long as the retirement test continues, one standard should apply to all Social Security beneficiaries. It is illogical to have a more stringent retirement test for beneficiaries under age 65 as in current law.

NATIONAL STUDENT ROUNDTABLE,
Washington, DC, March 18, 1987.

JOSEPH K. DOWLEY,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Longworth House Office Building, Washington, DC.

DEAR MR. DOWLEY: I am writing on behalf of the 12 million students enrolled in America's post-secondary institutions to caution you on the matters of applying social security taxes on the wages earned by students participating in the College Work Study Program.

The National Student Roundtable concurs with the testimony of Mr. Thomas Butts, representing the University of Michigan, and the statement of position made by the American Council on Education. Discontinuing the exemption for students from FICA taxes is a serious policy revision and one that concerns all of us in the higher education community.

As representatives of students in all sectors it is incumbent on the National Student Roundtable to speak out for the interests of its constituency. To that end, I have attached testimony which highlights particular student concerns on this issue. I would appreciate your including this material in the hearing record.

Thank you for your time and attention to this request.

In the Student Interest.

JOHN D. SKARE,
Executive Director.

STATEMENT OF THE NATIONAL STUDENT ROUNDTABLE, JOHN D. SKARE, EXECUTIVE DIRECTOR

The 8 million postsecondary students represented by the National Student Roundtable are concerned about the proposal of applying FICA taxes to earnings from the College Work Study Program. We feel it would better serve the interests of the social security system and the nation to continue the current policy of exempting students earnings. Furthermore we recommend that Congress study policy alternatives that might better meet the fiscal and social needs of a nation struggling to balance a budget and the welfare of its citizens.

TAXATION PLACES UNDUE BURDEN ON STUDENTS

The application of social security taxes to College Work Study earnings not only burdens the administrative functions of institutions, it represents a user fee for students participating in the program. No other federal aid grant program is taxed in such a manner. We share the concern of ACE that institutions will come under new and heavy costs of providing Work Study programs. As in the private sector, institutions will be inclined to pass on these increased costs to students via higher tuitions. Thus, the imposition of social security taxes on College Work Study is inflationary and an undue taxation of students.

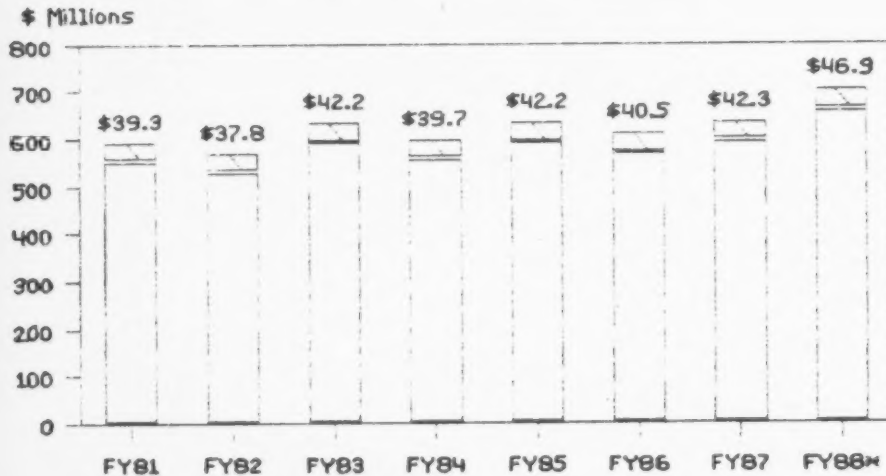
The economic impact on the student is important to understand. Not only will the student receive fewer aid dollars, she/he will likely face increased tuitions due to increased costs to the institution. This is a double-bind that hurts students.

TAXATION INCREASES FEDERAL COSTS

The FICA tax on student earnings would not occur in a void. The funds generated from students by the social security system, estimated at almost \$47 million under FY88 Budget Authority, would constitute a transfer of funds within the federal government. That only represents the student share; whose pocket the employer/institution share comes out of is unclear. Two things will happen: either the Department of Education will lose funds designated for the College Work Study Program, or Congress will be forced to increase Department of Education appropriations by \$47 to \$94 million in order to offset the budget shortfall. The most apparent effect of this policy decision will to increase the government's cost of program for College Work Study.

IMPACT ANALYSIS: FICA TAX ON WORKSTUDY ADDITIONAL COST OF PROGRAM

To Federal Government



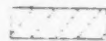
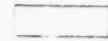
Calculations based on DOE figures
FY88 represents Budget Authority

TAXATION DIMINISHES ACCESS TO EDUCATION

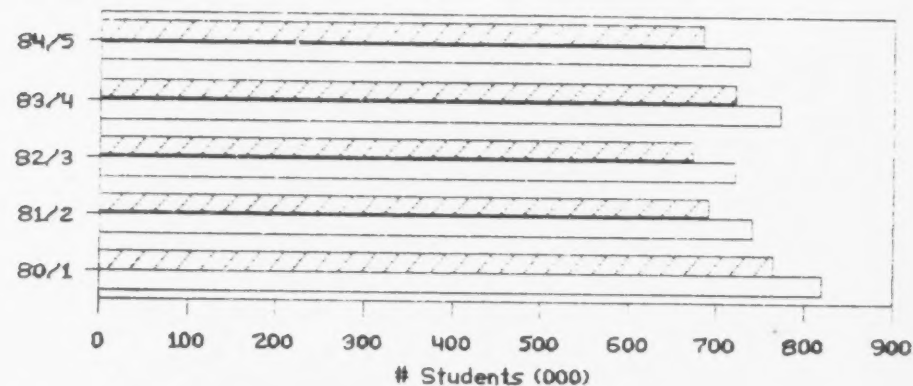
The proposal for eliminating the social security exemption comes at a time of great strain on federal student aid programs. The President has proposed a 46 percent cut in student aid, including the elimination of College Work Study itself. Adding to this political pressure, consider that students have faced real tuition increases in this decade that have been twice the rate of inflation. Students find themselves between a rock and a hard place: tuition and college costs are increasing; student financial aid is becoming more difficult to get; and, now, the aid students might get will be taxed.

IMPACT ANALYSIS: FICA TAX ON WORKSTUDY LOSS OF STUDENTS

Current Policy Proposal



Academic Year



Calculations based on DOE figures

Assumes no additional funding of program

It is a difficult position, indeed. If social security taxes had been applied to College Work Study these last several years, over 250,000 students would have been shut out of the program because of increased government costs.

And a "simple" tax of 7.15 percent represents a 5-year loss of some \$250 million in student earnings; money that would have helped defray the increasing cost of going to school. And the hardest hit would have been students from low and middle income families: 65 percent of Work Study funds go to students with family incomes under \$24,000 annually. The very people in America who need the assistance to achieve a higher education, not to mention the "American Dream," are those most severely affected by this proposal.

A STUDENT EXEMPTION IS FAIR

The purpose of the College Work Study program is to provide part-time employment for postsecondary students who need earnings from employment to finance their course of study. The tax for the social security system is designed to provide a safety net for Americans who find themselves unable to work for a living. The policy of an exemption for students enrolled in higher education is fair not only to our society at large, but is also fair to students. While they learn job-related skills and provide valuable services on campus and in the community, students are preparing themselves to be an important part of America's future. The exemption is fair because it recognizes the future earning potential of students and the significant contribution graduates make to both the nation's treasury and social welfare. Treasury estimates show college graduates contributing \$650,000 over their life-time in taxes.

What is not fair is the placement of barriers on access, in the first instance, and the limitation of individual potential, in the long run. Students are already hard-pressed to meet the expectations of academics, work, and a social life. A loss in earnings will only serve to increase the pressure today's students feel in meeting the costs of postsecondary education. And since social security benefits are calculated as an average of life-time contributions, the long-term effect will be to lower eventual benefit payments to these students. Why should students who participate in College Work Study in effect be penalized for working in college while other students, who receive grants or loans, receive higher benefits in the end?

It is not fair, either, to expect students to remain competitive in their classes or their professions if they have to give up study time and work more hours in order to make up the income loss due to taxes. Students who stand in line at the financial aid office know the current emphasis on loans over grants puts them at an economic disadvantage to their foreign cohorts. A FICA tax would exacerbate an already problematic trend toward loans and further threaten current levels of service in student aid.

In conclusion, the National Student Roundtable strongly supports a FICA exemption for College Work Study earnings. The exemption for students was conceived as an appropriate endeavor by the government to support those of our society who wish to improve themselves. Years of valuable service, thousands of lives, and millions of dollars should not be forsaken for expedient budget policy. College Work Study and Social Security have worked well in meeting the needs of Americans and we urge you to continue to support students and protect America's investment in higher education.

Before the
Subcommittee on Social Security
Committee on Ways and Means
United States House of Representatives

Statement of Keith Hartwell, Executive Director
Regional Railroads of America
324 Fourth St. N.E.
Washington, D.C. 20002

On proposals in the fiscal year 1988 budget relating to the
Railroad Retirement System.

March 5, 1987

Regional Railroads of America (RRA) is a coalition of thirty-six Class II and III railroads operating in thirty-two states. Its members have joined to foster a healthy economic environment for the operation of regional and local common carrier railroads. A list of the members of RRA is attached hereto as Appendix A.

A goal of RRA is to promote efficient and price competitive rail service to shippers and communities, especially those that would otherwise be in danger of losing rail service. RRA actively seeks the cooperation of the shipping community, and other interested parties toward creating a more competitive environment in which to provide more and better rail service and to create additional jobs.

The Regional Railroads of America was established on January 1, 1987. It is a new organization in an old industry. Its members operate more than five thousand miles of track. Individually they are small businesses and, without exception, are subject to intense competition from truck and often barge. It is the objective of the Regional Railroads of America to achieve government policy that will allow its members to be treated like other small businesses in this nation. Most especially RRA will urge government at all levels to place its members on a level playing field with our competition.

The Railroad Retirement System represents an enormous federally imposed cost to regional carriers. Because of the worsening employment outlook in the industry the Railroad Retirement System faces bleak prospects of increased costs or reduced benefits or both. There is a limit beyond which member lines cannot absorb non-productive cost increases and remain competitive with the truck competition.

The Administration Proposal

Among its recommendations, the Administration's FY 1988 budget proposes a 1.5% increase in the Tier II Railroad Retirement tax rate effective January 1, 1988, and a second 1.5% increase on January 1, 1989. It is also proposed to transfer part of the cost of vested dual or "windfall" benefits to the rail sector.

The high level of taxes to fund the Railroad Retirement Account is a matter of serious concern to Class II and Class III railroads.

Both employer and employee pay the Tier I tax, equivalent to that paid under social security, at a 1987 rate of 7.15% on an earnings base of \$43,800. The rate will increase to 7.5% in 1988, and to 7.65% in 1990. The Tier II tax funds old age and disability benefits over and above the Tier I or social security equivalent benefits. Rates applicable in 1987 to the Tier II tax are 14.75% of taxable compensation (\$32,700) for employers and 4.25% for employees. The employer also pays currently a supplemental tax of 24 cents per man-hour of work. This tax funds supplemental benefits to retired long-term employees. Thus, currently the railroads pay a combined rate of 22.61% for the Tier I and Tier II taxes, on the Tier II taxable compensation base. The supplemental tax adds another 2.04%, for total taxes of 24.65% of the Tier II taxable base. Employees pay for Tier I and Tier II taxes a total of 13.83% of the Tier II taxable base.

Unfortunately, the tax rates are not stable as the Administration's FY 1988 budget proposals make abundantly clear. Apart from those proposals currently the subject of the Subcommittee's hearing, the Tier I and Tier II tax base escalates depending on increases in the national level of wages.

The proposed 3% increase in the Tier II tax rate comes at a time when small railroads face intense competition from both truck and barge. The rail industry has seen its share of Intercity Freight Revenues fall from 23.1% to 16.8% in the 1973-1985 period. During the same period, originated tonnage by rail fell more than 12% from \$1.59 billion to \$1.44 billion while truck originated tonnage rose more than 22% from \$1.74 billion to \$2.14 billion.

Employment during these years has fallen steadily as Railroad Retirement Board reports furnished to the Congress indicate so clearly.

If railroads are to compete successfully and arrest the traffic losses sustained in recent years, they must achieve significant improvements in productivity, with a resulting ability to meet the price competition from other modes of transportation not faced with heavy right-of-way maintenance and improvement costs.

For these reasons, RRA is most concerned about Administration proposals to increase Tier II Taxes by a total of 3%, and to place on the rail industry 25% of costs of financing windfall dual benefits.

RRA Opposes Tier II Tax Increase

RRA opposes enactment of a 3% Tier II tax increase at this time. The Section 502 report of the Railroad Retirement Board, submitted to Congress in June 1986, makes it clear that there is no immediate crisis facing the Railroad Retirement System. In the technical views of the Board's Chief Actuary (a part of the Section 502 report) it is set forth that the retirement system's fund is expected to grow for several years without new legislation, even under the most pessimistic assumptions, and that there is no immediate danger of having to curtail benefits in the absence of additional financing.

The Chief Actuary further states that the recommendations, in terms of tax increases, are not meant to exclude the possibility of reducing any tax increase by adjusting benefits, and that Congress might find it appropriate to allow labor and management to prepare joint recommendations concerning the proportion of tax increases to be borne by employer and employee, and what, if any, adjustments are to be made in benefits.

As a minimum, RRA believes that a sufficient time should be afforded for the concerned taxpayers to make recommendations to the Congress.

RRA Opposes the Windfall Benefits Proposal

RRA opposes strongly the Administration's FY 88 Budget proposal that 25% of the costs of vested windfall dual benefits be paid from the Railroad Retirement Account funded from Tier II taxes paid by the railroads and their employees.

RRA concurs with the position on and discussion of this issue as set forth in the joint statement filed by the Association of American Railroads and the National Railway Labor Conference with the Subcommittee.

The proposal would require an additional Tier II payroll tax which the Railroad Retirement Board estimates would be equivalent to an increase of 1.1% during FY-88.

In 1974, the Congress isolated the social security component of Railroad Retirement so that only one social security benefit would be paid. Under the Railroad Retirement Act of 1974, Tier I would be the equivalent to social security. Upon retirement, employees with more than 10 years railroad service would receive from the Railroad Retirement system a single social security benefit (Tier I) based upon any combined railroad and non-railroad employment. Tier II would provide an added benefit based only upon railroad employment and earnings. In the 1974 Act, Congress further placed the burden for payment of vested windfall dual benefits upon the government's general revenues.

In 1981, Congress considered related issues, and at that time made no change in its 1974 commitment to finance the entire cost of windfall benefits from general revenues.

Again, in 1983 and subsequently Congress reaffirmed the intent of the 1974 Act. This issue should be solidly at rest, and the latest proposal for an assessment of a portion of windfall costs to the rail industry should be rejected.

A Need to Restructure?

In the joint statement of the Association of American Railroads and the National Railway Labor Conference filed with the Subcommittee, it is stated (page 5):

In view of all these complex considerations, it may even be desirable to have another thoroughgoing restructuring of the railroad retirement system based upon an in-depth study such as the study by the Commission on Railroad Retirement that preceded the enactment of the Railroad Retirement Act of 1974. At present, however, we urge only that railroad labor and management be given more time to come up with joint recommendations as to the financing of Tier II railroad retirement benefits. While some informal initial discussions have been held, efforts to complete the current round of national wage and rules negotiations have been all-absorbing. Much more intensive discussions of railroad retirement are needed.

RRA believes that this suggestion, although tentative in nature, for "another thoroughgoing restructuring" may well be worthy of serious consideration by the Congress, as well as by all parties concerned with the future of the retirement system.

Unfortunately, history shows that railroad retirement problems are before the Congress with alarming frequency. The level of taxation to support the system may indeed be hastening the decline in rail industry competitiveness, with resulting adverse impacts upon the level of employment. As employment levels fall, more taxation is necessary and the spiral continues.

The burden upon the existing work force should not be overlooked. Each employee now pays the tax of 13.83% upon the Tier II earnings base. With three beneficiaries for each current employee, it seems inevitable that this burden upon employer and

employee can only become heavier. The time for a thorough study of this costly system may well be at hand.

Conclusion

The Regional Railroads of America recognize the enormous complexity of retirement issues. RRA has established within its organization, a Committee on Railroad Retirement and Regional Railroads. This committee plans to study retirement and unemployment issues facing these railroads and their employees, including potential options for mitigating the competitive disadvantage the present railroad retirement system creates.

In summary, it is fortunate that the Railroad Retirement cash-flow is currently strong enough that no retiree is in danger of reduced benefits for the rest of this century. Therefore, we petition this committee not to adopt the stop-gap tax recommended by the Administration while the interested parties search for a long-term solution. Further, we join with labor and the Class I railroad industry in opposing a windfall benefit tax on railroads and their employees.

The Regional Railroads of America represent a growing entrepreneurial spirit in the transportation industry. We ask you not to weaken us with a stop-gap tax that holds little hope for solving the larger problem. We pledge to work with you in searching for the long-term and permanent solution.

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